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HOT TOPICS IN GLOBAL EXECUTIVE COMPENSATION TRENDS

July 2024

On June 17, Southlea Group (Canada) proudly hosted an in-depth panel discussion featuring leaders from our GECN firms from our various regions around the world. This diverse panel included Farient Advisors (US & UK), HCM (Europe), Guerdon Associates (Australia, New Zealand & Asia) and 21st Century (South Africa). In this discussion, we explored various global executive compensation and governance topics. Despite working with companies in different geographies, with unique operating environments and stakeholder perspectives, there were many similar client experiences and a convergence of themes. Read our summary of the key themes this knowledgeable panel explored, which includes:

1. Aligning with organization needs
2. Pay for performance
3. Environmental, social and governance (ESG)

ALIGNING WITH ORGANIZATION NEEDS

An overarching theme was the need to address the tensions between good governance and the views of the proxy advisors (such as ISS and Glass Lewis) with the need to attract, retain and engage the right talent. Robin Ferracone at Farient summed it up well: "it is a collision course between doing something special outside the pay plans (e.g., someone is paid outside of the pay program) that may be a problem if it collides with standards of good governance."

Organization needs differ across geographies and industries. Amanda Voegeli at Southlea indicated that we are finding a bit of a pullback in turnover and talent demands in Canada. While there are still pockets of movement and demand for talent, there is a sense that the broader "war for talent" is subsiding. There are cases where this tension becomes more of an issue, particularly in growing companies that need to retain and promote key talent in hot skill areas like technology and AI.

Boards continue to struggle with the interpretation of market data. Amanda indicated that the need to follow the 50th percentile is engrained within the Canadian culture while Stephan Hostettler at HCM noted that Swiss companies apply more judgement when interpreting market data to account for market differences. Each year, companies must go to shareholders and get the overall compensation budget approved and when they reviewed budgets over a period of time, they found that they remain more or less stable year-over-year. Robin reinforced the need to get pay positioned appropriately within reasonable guardrails so that you "can let performance take care of whether the pay outcomes are high or low."

There are also challenges from an investor perspective as it is easier for a portfolio manager to follow ISS and Glass Lewis rather than develop their own policies. Stephan has spoken with portfolio managers and found that many do not necessarily agree fully with the proxy advisor policies. They also have different priorities and objectives, reinforcing the need to understand your shareholder base and their preferences.

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Gabe Shawn Varges, the Chairman of the GECN Group, noted that across regions the mandate of Compensation Committees is expanding, addressing new issues such as the connection of pay to sustainability and the oversight of talent across the organization. This is raising questions as to what profile to use to recruit Committee members given what he calls the “shifting borders” of these committees. Chris Blair at 21st Century indicated that in South Africa committees are addressing broader issues such as the wage gap and the inequities between the top and bottom earners. Many of the larger companies in South Africa are adopting living wage policies.

PAY FOR PERFORMANCE

Michael Robinson at Guerdon noted that “boards are trying to discern their way through the fog of what actual performance is and how good they are versus the hubris that management puts up about their performance.” He went on to comment on the pay for performance relationship and the research they conducted among Australian companies to test the variability of pay with performance over one and three-year rolling periods. They found that there tends to be outliers in every industry that are consistent outperformers in terms of sustained levels of return on capital and/or earnings growth. This may not translate into total shareholder returns (TSR) given their consistent and reliable performance, so it is important to understand performance beyond TSR and be able to effectively communicate to investors.

There are continuing discussions on the use of relative and absolute performance given that many perceive the proxy advisors advocating for a greater emphasis on relative performance. However, many investors like to look at absolute returns rather than relative. Stephan commented that they have a couple of clients combining relative and absolute TSR to address different investor perspectives on good performance. Amanda outlined the use of “Market Share Units” (MSUs) as a potential replacement for stock options. MSUs vest based on absolute TSR over multiple years (e.g., years 3 to 5) which can address challenges in smaller markets like Canada where relative performance comparisons can be difficult. In Australia, in addition to having 100% of the long-term incentives performance-based, there is interest in a variation on the MSU where the number of shares vesting is based on a multiple of the ending share price relative to the beginning share price.

As boards consider the pay for performance relationship, it is important to consider reasonableness. Robin wrote a book – Fair Pay Fair Play: Aligning Executive Performance and Pay – that outlines Farient’s proprietary model to test the pay for performance relationship in a pictorial manner. She indicated that it helps boards understand the sensitivity of realizable pay relative to realized performance.

These discussions are also becoming more integrated with executive share ownership. In Canada, there are many board room debates on how to reinforce more real share ownership tied to actual wealth creation instead of our historical focus on alignment, a fixed multiple of salary and the inclusion of unvested share units. Canada appears to be lagging Australia and Europe where there is a greater emphasis on real ownership, while in the US, the guidelines haven’t changed much and continue to sometimes include unvested restricted shares. Robin noted that some clients have adopted share matching programs that have been well received by investors and executives as way to support retention and encourage real share ownership.

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ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

Robin commented that "while we hear lots of discussion on "the backlash" to ESG, companies continue to develop and refine their sustainability strategies, and they do want to push on some of those objectives within the incentive plans." She also noted that there is an additional layer focused on the link to business value. In one example, she cited a manufacturer that is gaining confidence on their sustainability strategy and the importance of reducing greenhouse gas (GHG) emissions, so they added a measure on GHG emissions but on a work adjusted or "intensity" basis.

Michael noted that the Australian economy is very similar to Canada. There is a large focus on GHG emissions reduction; however, boards are struggling with addressing the time challenges associated with making meaningful progress against longer-term goals. Many companies need to spend significant capital expenditures on GHG reducing activities rather than other more immediately productive assets, which can impact TSR over the short-term. This creates challenges beyond the decision of whether to include ESG measures within the incentive plans, but also recognition of the impact that these sustainability investments can have on future financial and market returns.

Chris explained that South Africa is still developing in its ESG maturity with the large global companies demonstrating market-aligned practices and smaller, local companies addressing more pressing issues. He reiterated the timing challenges and different expectations from ESG activists relative to shareholders and the ability for companies to make meaningful progress in the short-term. Chris went on to state that: "we will probably need to see a meaningful increase in the weighting of ESG within incentives to force executives to prioritize strategies that drive positive ESG outcomes."

SPEAKERS

Amanda Voegeli - Connect President & Managing Partner, Southlea Group Canada	Robin Ferracone – Connect Founder & CEO, Farient Advisors U.S.A. and U.K.
Gabe Shawn Varges - Connect Senior Partner, HCM International Europe	Michael Robinson – Connect Director, Guerdon Associates Australia, New Zealand and Asia
Dr. Stephan Hostettler - Connect Managing Partner, HCM International Europe	Chris Blair – Connect CEO, 21st Century South Africa

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