Alternative remuneration frameworks may not be well received by proxy advisers – timing is everything

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Proxy advisers and institutional investors, to their credit, have been fairly open to alternative executive remuneration frameworks these last two proxy seasons.

That window of openness is closing.

While it can be argued that proxy advisers and investors have not allowed enough time to evaluate outcomes, what they have seen is turning them off – with issuer behaviour seeming to confirm initial concerns about alternative frameworks. (See HERE.)

To date, two alternative remuneration frameworks to the traditional "fixed, STI and LTI" have been promulgated; the "hybrid" combined STI and LTI model, and the deferred STI only model.

It is the latter version where problems have arisen. Culprits have been companies that award STIs when performance has been poor. Proxy advisers and investors have become suspicious that the deferred STI model leaves too much discretion to companies to set soft targets. This is why they are insisting on better disclosure regarding STI KPIs and the mechanics that deliver the incentives.

There is also the view that the alternative is being suggested purely because the outlook for LTI vesting under the traditional model is poor, given the company's circumstances. Alas, in some cases, they would be right.

Companies that display the above behaviour are doing a disservice to others that have brought a good deal of intellectual rigour into assessing alternatives that are fit for purpose.

And the range of alternatives is almost limitless. In a five-minute discussion Guerdon Associates came up with ten alternative frameworks. After another five minutes we could come up with ten more. The challenge is to develop one that is best fit for purpose. And for many ASX-listed companies, this is not likely to be the traditional model, the hybrid model, or the deferred STI model.

Then there is the issue of timing. The right time to implement an alternative framework is when the company is hitting its targets, executives are receiving their incentive payments and the board is basking in the praise of investors.

This may seem counterintuitive. “If it ain’t broke, don’t fix it” is an oft used saying in corporate circles. And one it generally pays to follow.

However, there are two cases where the old adage needs to be ignored.

1. Sterling company performance is masking problems with the remuneration framework

In remuneration as in strategy, the job of a Board is to be able to see beyond fair weather to the storms ahead.

2. The remuneration framework works, but it is not the best for the job

There will be cases where a stock standard, cookie -cutter, short and long term incentive will be the best structure for the company. But often there will be something that works better. It might be that the alternative framework provides a better line of sight, or more effectively manages risky behaviour, or encourages performance on more relevant measures, or simply costs less to achieve the same motivational power.

If either of these cases is true for a company, an alternative framework should be part of the remuneration committee’s discussions – no matter how smooth the sailing is.

Proxy advisers and investors are less likely to respond well when bad times roll around. It takes more work to convince them that this is not just a method to ensure executives are paid more. There is nothing more likely to induce scepticism in an investor or proxy advisor than a board advocating an incentive plan change when executives are getting nothing. No matter how fit-for-purpose the new framework is, the board will face an uphill battle in this situation to receive shareholder approval for new plans.

So, if the storms are upon you and your board is beset by woes, it may be an inopportune time for an alternative framework. Consider waiting for the uptick and do it then.

And for those boards who are enjoying star performance – now is the time.