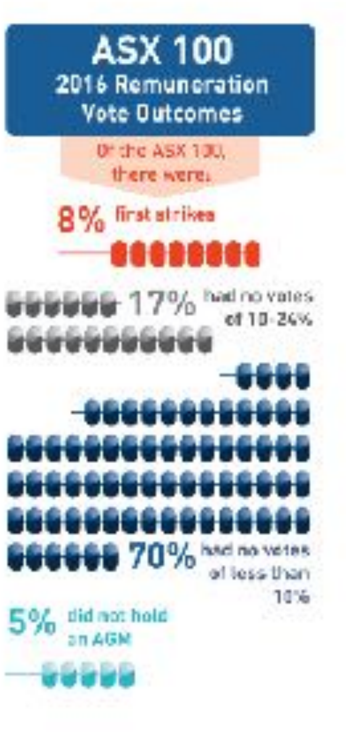
Remuneration and investor revolt

The 2016 AGM season in review



Eight first strikes and 17 no-votes of 10% or more against the remuneration report in the ASX 100[1]: the 2016 AGM season was remarkable for the level of open dissent between boards and investors.

Here's what we can we learn from a year that saw more than a quarter of ASX 100 AGMs resulting in substantial votes against the remuneration report.

What was that all about?

It's about performance

In an uncertain climate, investors are demanding better explanations of how management performance is measured and how it contributes to shareholder returns. All of the ASX 100 companies with first strikes, and many outside the ASX 100, operate in either the resources or the financial services sectors: both sectors currently facing significant uncertainty.

Interestingly, the focus also seems to have narrowed, with no substantial protest votes or commentary around environmental or other long-term sustainability issues (but see 'Culture and Risk', below).

It's (often) not about remuneration

A no vote is a shot across the bows of the board by disgruntled investors. It generally reflects a broader dissatisfaction with management or the board: remuneration structures and outcomes which might sail through other AGMs become a concern.

Of the eight first strikes in the ASX 100, seven were against the background of poor share price performance, recent scandals, or concerns about the ability to deliver future results. This is even more marked at the smaller end of the market. Fifty three companies outside the

[1] Based on analysis of ASX 100 AGM outcomes in The Executive Remuneration Reporter *2016 Year in Meetings* – see http://theexecutiveremunerationreporter.com.au

ASX 300 received first strikes in 2015; of these, nine were no longer operating by 2016 (through voluntary administration, scheme of arrangement or takeover)[2].

The rise of the proxy advisor

In a continuation of the trend of recent years, proxy advisors have an increasingly high profile, and are more likely to recommend a 'no' vote on motions put to an AGM. Companies who have previously relied on their reputation and established relationships with institutional investors may find this development uncomfortable, but it's a phenomenon that's unlikely to go away. Proxy advisors do not yet have the level of influence they wield in Europe or the US (where funds holding huge portfolios tend to rely on them more heavily) but they clearly have an impact.

The thorny question of culture and risk

Concerns around corporate culture and risk management often underpin investor dissatisfaction. Boards may be seen as passive or complacent, unwilling to hold senior management to account. Where pay outcomes do not match performance or where pay has grown substantially, investors may conclude that the board is hostage to management on pay issues – and may well be similarly incapacitated on issues of culture and risk management.

At the same time, there is also a strong vein of cynicism about the inclusion of non-financial performance measures in executive pay, which are sometimes seen as low-risk and therefore a means of rewarding management for just doing their job.

Lessons to be learned

1. Join the dots

Much of the commentary around remuneration involves complaints about unclear, incomplete or inconsistent information. Investors never consider the remuneration report alone. Despite this, companies often produce remuneration reports in isolation from other communications.

Disclosure of performance measures and links to shareholder value in the remuneration report should be in lockstep with the risk and strategy discussions in investor briefings and the Directors' Report. A complete and consistent story reassures the market that the board and management know what they are doing.

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[2] Given that the remuneration structures of companies at this end of the market are rarely complex or contentious, it's unlikely that unpopular remuneration contributed to their demise, and more likely that the voting patterns reflected a greater concern with performance. See The Executive Remuneration Reporter *2016 Year in Meetings* at http://theexecutiveremunerationreporter.com.au for more detail.

Demonstrating how non-financial measures of performance contribute to shareholder value is a particularly thorny issue. Investors are wary of the potential for loosely defined measures to act as a means of delivering risk-free virtual pay rises. Providing specific details about the calculation and measurement of non-financial performance is (arguably) not required by the *Corporations Act*, but may be a practical necessity where such measures are new, linked to a substantial proportion of potential earnings, or otherwise contentious.

2. *Take all year*

Ongoing engagement is critical. Surprises – even positive surprises – have the potential to undermine confidence in management's understanding of the environment and of the business itself. The same applies to remuneration. Where changes to remuneration are being considered or where outcomes are tracking to vary from previous years, or from this year's results, early engagement with investors and proxy advisors can be helpful to head concerns off at the pass.

Put yourselves in the shoes of your investors. Consider what information they are likely to ask for – or, even better, ask them what they want to know.

For companies that struggle to get the full attention of market commentators and investors – such as many small caps and recent IPOs – telling a clear and consistent story becomes even more critical.

3. *Lead from the top*

Many companies produce the annual report by binding together a set of disparately produced 'chapters', without any attempt to meld them into a consistent story. The root cause of this is usually structural: each functional area produces its own material and the owners may resist any attempts by investor relations, corporate affairs or other functions to encroach on their territory.

Intervention by the CFO, CEO or Board is almost always required for this to change.

4. *What's needed – not what's required*

Despite the sensitivity of the topic, the remuneration report is frequently treated as a compliance exercise. What's more, it's often the only communication with the market on executive pay.

Put yourselves in the shoes of your investors. Consider what information they are likely to ask for – or even better, ask them what they want to know. Aim to weave that information into a clear and consistent story, and any compliance-led detail that isn't of interest can be filled in if necessary.

Need help telling your story to the market? Contact Vanessa Richards on vanessa@vanessarichards.com.au or +61 481182119