

Revisiting incentive compensation packages

“What is measured gets managed” is a common but realistic statement related to considering the design of incentive compensation systems. Value Adviser Associates primarily designs packages that have performance measures that link to the drivers of shareholder value ([see Valuation Matters, December 2010](#)). Similarly we recognise that performance plans need to be expensed under AASB 2. Consequently this is another important consideration when designing a package – how easy is it to value it?

We are just completing a review of a sample of 70 listed companies including 50 of the top 100 companies across industry sectors and around 20 small to mid-size companies, to update our understanding of practices in the structure of incentive compensation packages and the type of performance measures used for top executives. We would be happy to share this with you. Some highlights are:

- » An analysis of the make-up of executive remuneration by base, short-term incentive (“STI”) and long-term incentive (“LTI”) components across industries, showing significant variation in remuneration structure employed;
- » Short-term measures used by companies included both financial and non-financial measures, but the type of measures employed varied significantly, with around 35% using an economic based measure such as EVA, cash flow or ROI. In addition, the use of traditional accounting measures such as NPAT and EPS is still strong;
- » Short-term incentives are mostly structured as a cash reward;
- » The majority (70%) of long-term incentives included a market component, usually a measure of relative total shareholder return (“TSR”) versus a select peer group;
- » However, a significant proportion (43%) included both a market measure (such as TSR) and an internal measure of performance such as NPAT or EPS;
- » Long-term incentives are mostly structured as performance rights following changes to the taxing of options in 2009;



- » In addition, a growing proportion of companies have minimum shareholding requirements to maximise the “wealth leverage” of senior executives to shareholder value.

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