Attracting long-term shareholders is a key issue in directors' remuneration

MM&K Remuneration Dinner

On 20th January 2014, MM&K hosted a dinner for Chairmen, Remuneration Committee Chairs and Chief Executives. The topic for discussion was shareholders and executive remuneration.

Summary of discussion

It is important to engage with your shareholders on remuneration issues but it might prove difficult to get their attention. Some flexibility in the application of policy is essential because of changing circumstances in a company and the wide differences in remuneration needs between different companies. Only dialogue can avoid misunderstanding. In practice, however, shareholders have no real concerns about remuneration in the majority of companies, especially those which are performing well.

It is probably unrealistic to think you can influence to a great extent who your shareholders are – they will come and go as they choose, and executive remuneration policy is unlikely to be a major influencing factor in this.

Introduction by Paul Norris

- Investors are clearly thinking longer term than three years in relation to share-based remuneration. Fidelity, NAPF and Hermes are just some which have made statements encouraging shareholding beyond the traditional three year vesting.
- What type of investor do you want to attract? The answer should help to decide on appropriate performance measures and remuneration policy.
- What is long term? The investment and return cycles of a mineral resources or pharmaceutical company are many years long. But three years may be long term for a fashion retailer. Remuneration policy should reflect the investment and return cycles of the business.
- Does it really matter if individual institutions come and go? What's important for companies is a liquid market.
- What will continue to attract supportive investors to your company? A good story and management track record are essential. The new directors' remuneration reporting regulations give companies an opportunity to tell their stories clearly and explain the linkages between the incentive plan design, corporate strategy, risks and KPIs. A constructive dialogue with investors is also essential.
- Institutional shareholders have told us they do not have time to read everything in the remuneration report. So take every opportunity to get your message across, eg consider including some KPIs with the 10-year graph.
- Shareholders now have a binding vote on remuneration policy, so it is now even more important to explain it clearly.
- Investors want to see that the management team are properly motivated and rewarded if they are successful in delivering the strategy. But investors need to understand the strategy and see how it is supported by remuneration policy.

1 Bengal Court, Birchin Lane, London, EC3V 9DD
t: 020 7283 7200 f: 020 7283 4119
e: info@mm-k.com www.mm-k.com

Discussion followed:

Engaging with fund managers

- Fund managers are not interested in a company's remuneration unless the company is doing badly. They want to see some shareholding and incentive plans in place. But beyond that they are only interested in strategy and performance.
- It depends who you define as the investor. One participant spoke of a fund management firm that voted down a remuneration report where none of the individual fund managers in the firm had any idea that this had happened. There is a division between the fund managers and the corporate governance staff in these firms. The fund managers hold the power although the corporate governance people can affect your media image.
- Another participant said that things are changing. The corporate governance people are becoming more active and influential in investment management firms – in four recent shareholder meetings attended, the governance people had been there each time. He thought it was important to have a sensible dialogue with the investors on remuneration issues.
- One person responded that the expectation in the Government's new voting and reporting regulations is that shareholders would increase their resources in order to consult more effectively with their investee companies. But it hasn't happened. Another said institutional investors have in fact been cutting down on staff – they have outsourced much of the task – particularly to ISS, the US owned shareholder services group. The problem is that investment firms do not generally see remuneration governance as a source for competitive advantage with their own clients, the ultimate investors. One person said he had no problem with the new rules – but it is a disaster if the investors do not have the resources to talk to you.
- A participant whose firm is in venture capital said that private equity firms do not necessary make better governance decisions with their portfolio companies – but there is a closer forum for discussion about issues.
- One participant said he tried to contact the major shareholders in advance. But the problem was finding the right person in the fund management firm to talk to. The regular fund managers do not want to shine the spotlight on the issuing company's policies.
- You might think that a vote of only 10% against the remuneration policy is a good result – but you need to remember that you might want the votes of those members another time for another issue, such as a takeover.
- Remuneration reports have now become far too long and too complicated. Nobody reads them now. It is so important to talk to the owners.

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Shareholder restrictions on remuneration policy

- The Chairman of a mining company said the investors need to understand how different circumstances can lead to quite different pay policy requirements in order to motivate people. Recruiting, retaining and motivating key employees still remain the main objectives of pay policy.
- The policy of PIRC, the proxy advisory service, was mentioned. PIRC say their research shows that LTIPs have paid out but performance has not improved. So they are opposed to any new long-term incentive plans. The joint policy of Hermes, Rail Pen and USS was contrasted with this – they want companies to have policies that lead to executives holding shares over the long-term.
- One diner said he believed Herald Investment Management have come out against nil-cost options as a blanket rule. Another said that this would be an extraordinary policy, given that 80% of long-term incentives are LTIPs and many of these are structured as nil-cost options nowadays.
- Companies need the discretion to reward people for getting the company through troubled times. Participants were concerned that investor guidelines on the new policy vote would prevent them from applying the right amount of discretion – it is unsatisfactory. One participant argued that, despite their political origins, the new Directors' Remuneration Reporting Regulations provide a good opportunity for companies to declare what their policy is and then show how they implemented it.

Encouraging long-term shareholders

- Shareholders will not generally hang in there for the long term. For example, sinking a mine-shaft is a seven-year project from beginning to end. But if the mineral price falls, investors will lose interest and will pull out. There is no linkage between remuneration policy and obtaining investor loyalty.
- One person asked if an investor would divest a company's shares on the basis of non-compliance with remuneration guidelines. Most attendees felt that commercial factors would trump compliance factors in this decision. But shareholders do not like surprises and some votes against the remuneration report relate to unexpected things popping up after investors had been assured they had been resolved.
- Investors will buy and sell as they wish. Companies can only influence this to a limited extent. The biggest opportunity to affect your shareholder base is at the time of an IPO.

Conclusion: the whole governance/remuneration issue is in flux and it is down to each company to find the right answer for all stakeholders. There is a lot more water to flow under this particular bridge!

Note prepared by Damien Knight damienknight@mm-k.com 020 7283 7200