Remuneration committees must engage investors - IoDSA

The contentious issue of executive and director remuneration should be addressed directly through effective communication with investors, in order to rebuild trust between boards and shareholders. This is according to panellists at a breakfast event hosted by the Institute of Directors in Southern Africa (IoDSA).

A contentious issue

Arguably excessive payments to executives and directors in the face of poor corporate performance and global recession have made executive pay a rallying cry for shareholder activists.

"It's clear that the remuneration question has led to a major breakdown of trust between boards and shareholders," says the IoDSA CEO, Ansie Ramalho. "The only way round this impasse is for the remuneration committee to put in place a comprehensive process of dialogue with shareholders and stakeholders to build mutual understanding of this complex matter."

IoDSA has formed a Remuneration Committee Forum to help remuneration committees understand the issues and begin developing best practice. The forum's first position paper, A Framework for Remuneration Committees, highlights the need for such a framework, since no set of rules for remuneration committees exists as they are board committees, and are not provided for by statute.

A two-way street

One key challenge is that shareholders and their advisors often do not understand the complexities of remuneration strategies, pay scales and performance management and so may rely too much either on a mechanical "tick-box" approach or the reports of specialist analysts who themselves are not necessarily well informed. This can lead to misunderstandings, especially when remuneration committees take unusual steps in order to protect the company's best long-term interests. To overcome this comprehension gap, remuneration committees need to be proactive in communicating a more nuanced understanding to stakeholders and shareholders.

Importantly, though, this communication does need to be two-way, and shareholders must be willing to communicate reasons for their opposition to the company's remuneration policy and/or the amounts paid to senior leaders. Many investors are currently reluctant to do so, or do so only after the fact.

Pay versus performance

"It's clear that remuneration committees need to become much more effective and get more involved in the way the company works. In this respect, they need to follow the lead of audit committees," Ramalho notes. "To be successful, the company must reward performance that creates value. The remuneration committee must understand the company and its industry intimately in order to do so."

Ray Harraway, advisory director at Ernst & Young, the sponsor of the Remuneration Committee Forum, expands on this point: "Corporate governance in remuneration is evolving rapidly in South Africa. This is characterised by increased shareholder engagement, increased disclosure, and consistent calls for alignment of pay with performance. Remuneration Committees must ensure they understand corporate performance so that they can better assess the relationship between performance and pay. By linking pay and performance better, remuneration committees can help improve companies' sustainable performance."

The Remuneration Committee Forum's first position paper is available at www.iodsa.co.za.