

World rankings for SA companies, but CEO pay at odds

South African companies enjoy top rankings on the international stage yet remuneration of their CEOs is incongruous. This is according to Peter Aling, director of quantitative analysis of Prophet Analytics, which recently released its latest Labour Market Navigator report.

"South African companies are among the best-performing in the world and CEO performance bonuses are consequently substantial. However, local companies have a long way to go before CEO remuneration is appropriately incentivised and analogous across all private sector organisations."

Aling said that corporate profitability should be the sole rational basis for executive remuneration.

"In South Africa some CEOs are completely overpaid, given that they delivered a poor return on shareholders' funds and, similarly, others are underpaid."

Encouragingly, the latest Labour Market Navigator report shows a dramatic improvement in the past year in the relationship between CEO remuneration and corporate profitability, with the correlation rising from 23% to 30%. More managers are being rewarded for corporate profitability, both in cash and through the use of stock options.

Said Aling: "It is good for South Africa's standing internationally that profitability as a determinant of CEO remuneration has increased. Other factors, such as executive tenure, the number of employees and the value of assets under management have clearly decreased as determinants of CEO remuneration - and rightly so."

The report moots issuing stock options to management and reducing the use of cash as a performance incentive as tactics to align CEO remuneration with corporate profitability.

"We need to replace cash-based performance bonuses with stock options whose values rise and fall with changes in the underlying profitability and value of the firm," said Aling.

Meanwhile, in pay negotiations trade unions are increasingly focusing on the gap between CEO's pay and average workers, while politicians are calling for CEO remuneration to be capped.

Aling said: "None of these claims mention the rational basis for CEO remuneration, namely corporate profitability."

"After all, our report clearly illustrates that the proportion of South Africa's national income attributable to private business enterprises in the form of profits (as opposed to households in the form of wages) has increased from 39% in 2000 to 51% in 2012."

The JSE's top-10 overpaid and underpaid CEOs in 2012

The report goes on to cite the JSE's top-10 overpaid and underpaid CEOs in 2012. The most overpaid CEO in South Africa is Northam Platinum CEO Glyn Lewis, who was paid R11.1 million last year and generated a negative real return on shareholders' funds of -4.36%. By contrast, the most underpaid CEO in South Africa is Netcare CEO Richard Friedland, who was paid R11.8 million last year and generated a real return on shareholders' funds of 913.3%.

This year's first report by Prophet Analytics follows on from its 2012 study which found that CEO remuneration was not justified by company profitability and that there was a significant degree of variation between companies.

Said Aling: "This year we expanded our sample from 212 companies to 230 companies, mainly as a result of improvements in company reporting of executive remuneration. We retained the same basis for measuring corporate profitability, namely the excess return (over the market return) on shareholders' funds."

South Africa has some of the best-run companies in the world. According to a recent study, the real risk-adjusted return on capital of South African listed businesses is currently 10% - the highest in the world. In some notable areas including corporate transparency and board effectiveness, South Africa ranks number one in the world.

The private sector in South Africa, which includes such dimensions as the degree of business sophistication, is ranked 34th in the world, alongside Ireland, Chile and Israel; and the quality of professional management is ranked 13th in the world, alongside Denmark and Canada. South African companies' financial management ranks number one in the world.

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