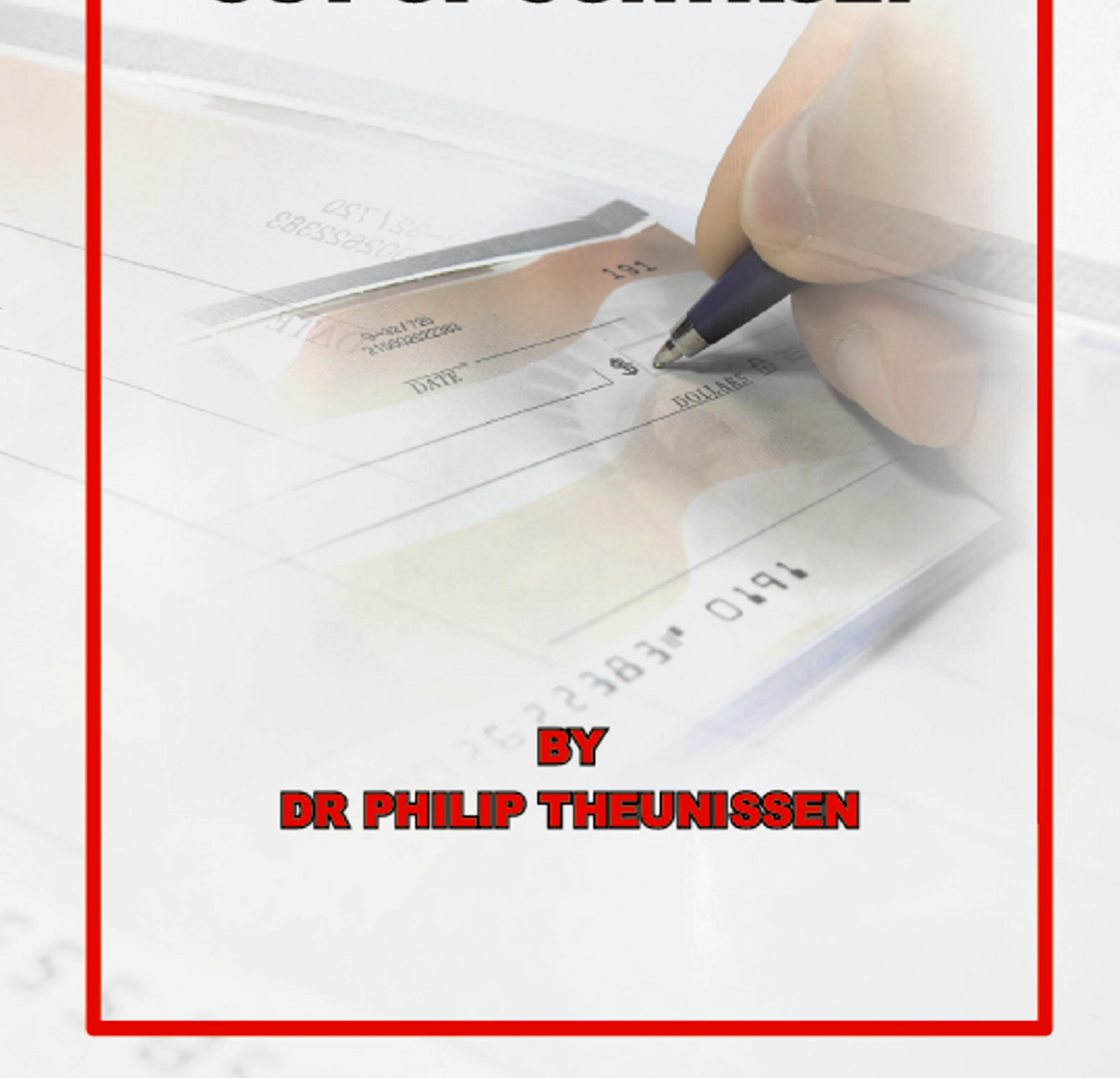
IS EXECUTIVE REMUNERATION OUT OF CONTROL?



BY
DR PHILIP THEUNISSEN

IS EXECUTIVE REMUNERATION OUT OF CONTROL?

BY
DR PHILIP THEUNISSEN

RESEARCH ASSISTANT:
MARLI THEUNISSEN

GRAMMATICAL EDITING:
BLANCHE NEL

TECHNICAL REVIEWING:
DR STEFAN STRYDOM

PRINTED BY:
HOOGLANDPERS (BETHLEHEM)

DISTRIBUTED BY:

COMPUTUS
Finansiële Rekenmeesters | Forensiese Rekenmeesters | Landbou Ekonome

BETHLEHEM
APRIL 2010

BACKGROUND

COMPUTUS

COMPUTUS MANAGEMENT BUREAU, CC started operating on 1 September 1991 as a bureau service in the Eastern Free State, specialising in financial record keeping for farmers from an agricultural economic vantage point. During 2001 COMPUTUS obtained membership of SAIPA (South African Institute of Professional Accountants) and extended its services to businesses other than farming enterprises. Since 2005, COMPUTUS gradually became involved as expert advisors in disputes with an agricultural economic nature and formally added forensic accounting expertise to its services since the beginning of 2008. COMPUTUS currently possess formal qualifications and membership to act as professional financial accountants, forensic accountants and agricultural economists. This is supported by practical experience in the area of financial record keeping, forensic investigations into disputes and advice regarding farm management.

In the course of almost two decades, COMPUTUS distinguished itself by adding valuable managerial information to its record keeping function, with the capacity to investigate disputes in a forensic manner. These services are not only utilised by farmers and businesses but also by bigger organisations for decision-making.

COMPUTUS gained credibility by emphasising the importance of supplying timely and accurate information. The rates are affordable and the products and services have stood the test of time.

DR PHILIP THEUNISSEN

Dr Philip Theunissen matriculated in 1976 at the High School of Wolmaransstad and he obtained a B Comm-degree at the Potchefstroom University after completing his military service. Philip started his career in 1983 as an economist at the South African Agriculture Union (now Agri SA) but accepted an appointment as agricultural economist four years later at Free State Co-operative. He was Financial Manager for a farming company in Paarl before he started his own accounting practise in 1991 in Bethlehem. He was involved with the development of correspondence courses for farmers on record keeping, tax and marketing and a part-time lecturer in Management at a technical college as well. He was a tutor at a technicon in computer software for farmers. He is in possession of a B Comm, Hons B Comm, M Comm (Business economics), M Comm (Forensic Accountancy) and a Ph D (Business economics). He is registered with the SA Institute for Professional Accountants.

Apart from the complete accounting function of COMPUTUS for farmers and businesses, his agricultural advice and consultancy covers topics like estate planning and succession, farm management, machinery management, enterprise analysis, cash flow budgets, agricultural economic comparisons and the interpretation of financial statements. He has been involved in several disputes between farmers and suppliers and amongst farmers themselves where his expert opinion was needed.

He is a part-time agricultural journalist and responsible for articles in most of the agricultural magazines in South Africa on a regular basis. He was appointed as agricultural journalist of the year in 1993 and in 2001, his article: *"When must a farmer stop?"* was appointed as the best article published in SA Grain. He has appeared as a guest speaker at several agricultural functions during his career.

His involvement in agriculture is also reflected in his post graduate research with an honours study titled *"Investigating the restraints of financing beginner farmers"*, a masters dissertation titled *"The effectiveness of agricultural co-operatives in providing production credit"* and a doctoral thesis titled *"Financial norms for a mixed farming enterprise in the Eastern Free State"*.

His interests are travelling, camping, hiking, mountain biking and photography. He is a part time sheep and fellow deer farmer.

CONTACT DETAILS

You can address your general enquiries to Dr Philip Theunissen per telephone at (058) 3039640 or by e-mail at philip@computus.co.za.

Visit our website: **http://www.computus.co.za/**

KEY FINDINGS

The remuneration of company executives (CEOôs) is an issue that has attracted considerable interest from shareholders, business groups and the wider community. The concerns regarding excessive remuneration packages of CEOôs has come on top of longstanding community discomfort about the widening gap between the remuneration of executives and other employees, as well as some large termination payments with perceived lack of justification. Public opinion polling over the years consistently shows that most respondents believe CEO remuneration to be out of control.

The main purpose of this study was therefore to determine if CEOôs in South Africa are indeed well rewarded, to the detriment of other employees, and if their remuneration can be justified in comparison with their performance. CEO remuneration of 326 companies, as reflected in their annual reports, were analysed by means of certain statistical formulae for the financial years ending between July 2008 and June 2009. The analysis indicated the following:

- The average CEO remuneration of all the companies studied amounted to R4.76 million per annum. The average CEO remuneration of the trimmed group (after omitting the top 10% and bottom 10% values) was R3.66 million per annum. The average basic salary of the CEOôs was R2.37 million per annum for the untrimmed group and R2.09 million for the trimmed group. In 2009 the average worker earned R124 457.00 per annum.

- The variable portion of CEO remuneration is positively linked to the performance of the Johannesburg Stock Exchange. In 2006 the 63% portion of variable CEO remuneration coincided with a bullish period of share prices on the JSE. However, in spite of the severe negative economic conditions, CEOôs were still able to double their normal annual earnings in 2009 with óperformance bonusesô while the JSE lost 42% in value during the deep recession. The variable portion of CEO remuneration dropped to 52% in 2009.

- CEO remuneration increased by 11.5% per annum on average from 2006 to 2009 while the yearly earnings of the average worker increased by 15.4% over this period. However, the average basic salary of CEOôs increased by 19.9% per annum from 2006 to 2009.

- The average remuneration of CEOôs was 39 times more in 2006 than that of the average worker. This ratio decreased to 36 times in 2009. The ratio of the average basic salary of CEOôs increased from 18 to 20 times over the same period. The decreasing ratio of total remuneration is therefore the result of a decrease in the variable portion (mainly performance bonuses) of the CEOôs in 2009.

- With the exception of executive mayors, public office bearers gained on their ratios with CEOôs from 2006 to 2009 while the CEOôs gained on public service workers over the same period. CEOôs still earn twice as much on average as the president of the country and three times more then the cabinet ministers. They earned ten times more than a director general in 2009 while they earned 106 times more than a cleaner in the public service for the same year. The ratios are 9 times and 98 times respectively for 2006.

- 78% of the CEOôs earned more in a month than what the average worker earned in a year. In 2009, it took just about three months on average for a CEO to earn R1 million while it will take the average worker eight years to earn the same amount.

- The landscape of executive remuneration has become far more sophisticated than it was a decade ago, and complicated share schemes and bonuses are key to that. Executive reward is multifaceted, typically including fixed short-term remuneration in the form of salary and benefits, fixed long-term remuneration in the form of pension, variable short-term remuneration in the form of annual bonus, and variable long-term remuneration in the form of deferred bonus and long-term incentive awards.

- Performance of the individual companies is by no means a determinant of CEO remuneration. Although slightly stronger, there is also no convincing indication that company size is a determinant of CEO remuneration. No single business factor therefore emerged as the main determinant of CEO remuneration. Other, less rational factors probably override the role that business factors play in CEO remuneration.

The empirical analysis was substantiated by theoretical information and discussions by numerous trustworthy sources. In summary it concluded:

- Performance-based remuneration, often in the form of share options, has been endorsed by researchers throughout the world as a way of addressing the principal/agent problem by aligning the interests of the shareholders and the CEOôs, who act as agents on behalf of the shareholders. There is a correlation between the size of the remuneration package and the variable portion of the remuneration, although no single business factor, least of all company performance, emerged as a determinant of CEO remuneration. Options are therefore not closely linked to the performance of CEOôs, allowing them to benefit from movements in share prices that were due to market and industry trends beyond their control.

- Although remuneration committee members approach their jobs with good intentions, intelligence, and integrity, they are not as diligent as they would be if they were spending their own money. The committee only sees plans that have already been óblessedô by top managers and although individual committee members are generally competent and well motivated, the governance system itself is corrupted and tilted in the direction of management in a way that will almost inevitably lead to excesses in the remuneration levels of CEOôs.

- Many remuneration packages are determined on the basis of what others in comparable jobs, regardless of performance, are being paid. This creates a natural ambivalence between remuneration and performance, as companies and executives seek to position themselves in the market, with no one wishing to be seen as hiring a below average executive.

The conclusion is that the current levels of CEO remuneration in South Africa is sending out the wrong message regarding fairness to the average worker as it is by no convincing means the result of exceptionally talented performances. Companies will however keep on rewarding their CEOôs with ever-increasing remuneration packages to convince themselves that their CEO is above average. Therefore no company will allow its CEO remuneration package to lag behind market trends and by doing so they keep on giving more momentum to an already dangerously spinning remuneration spiral. The result is that CEO remuneration is in all likelihood indeed out of control.

CONTENTS

LIST OF TABLES

LIST OF FIGURES

1. INTRODUCTION

The remuneration of company directors and executives is an issue that has attracted considerable interest from shareholders, business groups and the wider community. Concerns have been raised about excessive remuneration practices, particularly as there was almost unprecedented turmoil in global financial and equity markets during 2008 and 2009. Internationally, various forums have identified remuneration practices as a contributing factor to the global financial crisis. Strong growth in executive remuneration from the 1990s to 2007, and instances of large payments despite poor company performance, have fuelled community concerns that executive remuneration is out of control (Australia, 2009).

President Barack Obama imposed $500 000.00 caps on senior executive remuneration in February 2010 for the most distressed financial institutions receiving federal bailout money in the USA. As important as what Obama was saying, was the signal he sent out that his administration would look at executive compensation beyond banks and Wall Street. The president promised a look at a corporate culture that has rewarded top executives handsomely, while the income of workers, including those who are college graduates, has been largely stagnant for years (The Seatle Times, 2010).

People heading up the UKøs top companies seem to be paid more, almost regardless of the performance of the companies they run or their own performance in the jobs they do. As a committee report on trade and industry rather pithily puts it: *"It would appear that executives have been rewarded not only for success but for failure as well."* The contrast between those chief executives who have walked away from their companies with multimillion-pound pay-offs, despite their perceived poor performance, and what happens to every other group of worker when they fail, has struck many individuals and organisations as a little odd (Isles, 2006).

In Australia, excessive salaries, bonuses and termination payments have been the subject of much public outcry over the past year. National leaders and other politicians have expressed outrage at the exorbitant salaries and ógolden handshakesô paid to executives, often with little or no connection to the performance of the company they are leading (Brown, 2009).

In an interview by Financial Mail with then finance minister Trevor Manuel in August 2008, he said government was as concerned as ever about pay levels, especially where there is no relation to the performance of the company of the executive (Financial Mail, 2008). Manuel also felt excessive salaries were unjustified in the context of South Africaøs 23% unemployment rate and mentioned: ñ*In a country with the inequality and unemployment that we have, some of these exorbitant salaries are simply repulsive."*

The Black Management Forum (BMF) noted with concern ñ*the continuing hefty payments"* to Chief Executive Officers (CEOøs) of major industry players and says it is a slap in the face of poverty and joblessness. The BMFøs MD, Gaba Tabane, said many had been vocal about the exorbitant remuneration packages of CEOøs of state-owned enterprises in the past. *"Invariably, we expect South Africa to raise the same concern when the same happens in the private sector."* (Newsfin, 2010)

2. THE PROBLEM

The concerns regarding excessive remuneration packages of CEOÕs has come on top of longstanding community discomfort about the widening gap between the remuneration of executives and other employees, as well as some large termination payments with perceived lack of justification. Public opinion polling over the years consistently shows that most respondents believe executives to be overpaid (Australia, 2009).

For people at the top of private companies there are three main reasons given for why they deserve to be so well rewarded (Isles, 2006):

- The risks they bear in taking the position of CEO;
- The fact that they are more talented and have more responsibility than anyone else;
- The fact that they are working in a global labour market where Adam SmithÕs invisible hand of market forces is at work setting pay levels and contract terms on an ever upward spiral.

On the question of risk in being a chief executive (the first of the three arguments for high remuneration listed above), many well-researched and compellingly-argued books have been written on the subject of risk and who is taking it in the new world of work. Suffice to say that it is not the CEOÕs of large companies who are seen as being particularly at risk. Nor, arguably, as alluded to above, are the business strategies of most companies risk-inclined. If the history of the labour market tells us anything, it is that those most vulnerable to economic shocks are those furthest down the food chain of employability (Isles, 2006).

Woodburn (2008) asks the question: *"If the job of the chief executive is to create growth and generate profits for his company's shareholders, and he fails to do that, why should he automatically be entitled to a pay increase? Or does this not apply to those at the top of the corporate ladder?"* Shareholders in most of the major industrial countries are beginning to say that it does. There is no doubt that the heat is on, and South African directors and boards would do well to sit up and take note (Woodburn, 2008).

Excessive CEO remuneration is a worldwide phenomenon, if the vast number of allegations is anything to go by. The main purpose of this study was therefore to determine if CEOÕs in South Africa are indeed well rewarded, to the detriment of other employees, and if their remuneration can be justified in comparison with their performance. To achieve this, the specific goals of the research was:

- To give account of the current situation in 2009 regarding CEO remuneration and to compare it to a similar study done by the trade union, Solidarity, in 2006;
- To make comparisons between CEO remuneration and the earnings of other employees;
- To determine correlations between CEO remuneration and fundamental business factors;
- To discuss other factors that could be influential determinants of CEO remuneration.

3. THE METHOD

The author is aware of regular studies done by Mabili and PriceWaterhouseCoopers about CEO remuneration in South Africa. These two studies emphasise the mean or median remuneration packages and compare the trends over time. Analysis in this study, however, goes far beyond the mere mean and median calculations of current remuneration packages. Apart from comparing CEO remuneration to other salaries, it analyses the correlation between CEO remuneration with various business factors. This study is a singular attempt to put CEO remuneration in perspective and does not attempt to replace the aforementioned reports.

As already mentioned, Solidarity completed a similar study in 2006, although their analysis was done to a different extend as this study. However, the study done by Solidarity is a good comparative measure to determine the change in CEO remuneration from 2006 to 2009.

The published results of Mabili, PriceWaterhouseCoopers and Solidarity involved listed companies on the Johannesburg Stock Exchange (JSE). This study includes the same database, but added the CEO remuneration packages of parastatal companies. Companies categorised as AltX, Venture capital and Development capital were not included in the results of Solidarity. Where the results of this study are compared to that of Solidarity, those companies were therefore not included and indicated as such.

Link Market Services and Computershare were approached in November 2009 to provide the latest available printed annual reports of all the companies listed on the JSE. These reports were compared with the information of shares notated by Sake24 in Rapport of 15 November 2009. Annual reports of financial years ending between July 2008 and June 2009 were used for this study. Reports initially not supplied, were obtained either by further specific requests to Link Market Services and Computershare or by downloading the desired reports from the websites of the relevant companies. This method was also followed with initially supplied annual reports with financial years ending before July 2008. A summary of the annual reports of companies used in this study is shown in Table 1:

TABLE 1: SUMMARY OF ANNUAL REPORTS OF COMPANIES USED, 2009

Category	Listed	Not available	Not usable	Used	% used
NEW LISTING	1	0	1	0	0%
OIL AND GAS	3	0	2	1	33%
RESOURCES	73	9	24	40	55%
INDUSTRIAL	71	1	4	66	93%
CONSUMER GOODS	27	2	4	21	78%
HEALTH CARE	5	0	0	5	100%
CONSUMER SERVICES	40	1	10	29	73%
TELECOMMUNICATIONS	5	0	1	4	80%
FINANCIALS	81	6	21	54	67%
TECHNOLOGY	17	0	1	16	94%
ALTX	78	4	7	67	86%
VENTURE CAPITAL	6	1	2	3	50%
DEVELOPMENT CAPITAL	6	1	1	4	67%
PARASTATALS	17	0	1	16	94%
TOTAL	**430**	**25**	**79**	**326**	**76%**

As shown in Table 1, the annual reports of 326 companies could eventually be used to conduct sensible analysis. This represents 76% of the possible 430 companies that could have been analysed. The reasons for annual reports not being available were that these companies were either not active or an annual report could not be obtained. The main reasons for annual reports not being suitable is that a number of companies are operating from foreign offices and the CEOís are being paid in those countries, some companies were not yet in full operation (like newly established mining companies) or, for some reason, the CEO remuneration was not disclosed in the annual report.

CEO remuneration varies quite significantly at the top and the bottom of the range because of extreme high or extreme low values. Therefore, adopted from the study of Solidarity, the highest 10% and the lowest 10% cases were omitted from most of the analysis. The untrimmed group or ëuntrimmedí refers to the initial 326 companies from which suitable information could be obtained. Where reference is made to the trimmed group or ëtrimmedí, it refers to the 262 companies representing the remaining 80% of companies after the initial 326 were sorted by CEO remuneration from the highest to the lowest and the top 10% and bottom 10% were omitted. Some tables refer to this database as ìInclusiveî.

In some tables there are comparisons made with the database used by Solidarity. This database excludes the Parastatal, AltX, Venture capital and Development capital companies in alignment with the database used by Solidarity in 2006. The database excluding these companies is referred to as ìExclusiveî.

Summarised, there were two sets of data used: one with all listed companies inclusive of AltX, Venture capital, Development capital and the parastatal companies and the other one exclusive of the latter categories of companies to make a comparison with the Solidarity study possible. Both sets are reflected in full (untrimmed) as well as by ëtrimmedí values.

The empirical analysis in this report is supported by theoretical information. Several documents were obtained from the Internet in this regard and are listed at the end of the report and also indicated where necessary in brackets at the end of the relevant paragraph.

4. THEORETICAL BACKGROUND

The landscape of executive remuneration is far more sophisticated than it was a decade ago, and complicated share schemes and bonuses are key to that (Financial Mail, 2008). Executive reward is multifaceted, typically including fixed short-term remuneration in the form of salary and benefits, fixed long-term remuneration in the form of pension, variable short-term remuneration in the form of annual bonus, and variable long-term remuneration in the form of deferred bonus and long-term incentive awards (PriceWaterhouseCoopers, 2010).

In exchange for the remuneration, the Companies Act (Act No.71, 2008) requires in section 76 (3) from a director of a company, when acting in that capacity, to exercise the powers and perform the functions of director:

(a) in good faith and for a proper purpose;
(b) in the best interests of the company; and
(c) with the degree of care, skill and diligence that may reasonably be expected of a person:
  (i) carrying out the same functions in relation to the company as those carried out by that director; and
  (ii) having the general knowledge, skill and experience of that director.

4.1. NEGOTIATIONS

Ideal remuneration structures vary due to different risk preferences across companies and individuals. The Australian Productivity Commission found the following (2009):

- In some fundamental ways, the market for executives is similar to other labour markets. In principle, employers will be prepared to pay up to the value of a workerôs contribution, while employees will want remuneration (pecuniary and non-pecuniary) that is equal to at least what they can earn elsewhere, or can enjoy in other pursuits. However, the eventual outcome will also be influenced by information available to each party (concerning, for instance, the quality of the person or the nature of the work), and any other sources of ônegotiatingô power. Such information ôasymmetriesô are particularly important in the market for executives, because of the principal/agent dichotomy that arises from separation of ownership and control of public companies.

- A chief executive answers only to the board that hires, rewards and occasionally fires him or her. Consequently, the nature of the relationship, including the balance of power between boards and executives, plays a crucial role in the negotiation of remuneration levels and structures and in determining how effective they are in aligning executive actions with company interests in practice. In turn, the degree of alignment between the boardôs actions and the interests of the shareholder body it represents is crucial for the efficiency of executive remuneration outcomes.

- In the context of the market for executives, efficiency would require that companies hired the most suitable executive for them, paying up to the value of the contribution of the particular executive in that position (including any ôspill overô-effects on other employeesô productivity). Due to each executive having different abilities, there will not be a single market ópriceô, just as there is no single price for differentiated goods and services. Therefore, in a reasonably well-functioning market, differences in executive remuneration ultimately would reflect different levels of talent and ability in broadly similar jobs, as well as the different nature of jobs. Furthermore, it would be expected that the returns to ótalentô would largely be appropriated by the owners ð that is, the executives. In this way, the price mechanism ensures that the most highly talented executives are allocated to their most highly valued uses.

4.2. KEY DRIVERS

How much to pay a CEO usually arises in one of two quite different settings: when hiring a new CEO, and when discussing whether to give the current CEO a raise. There are no hard and fast rules to setting a remuneration package level, and there are certainly no simple tables to check. Some general principles, however, do apply at every point (ourcommunity.com.au, undated):

- The remuneration should be enough to attract the right candidate;
- The remuneration should be able to be sold as fair in the context of other salaries in the organisation;
- The CEOôs remuneration shouldnôt stress the organisationôs finances;
- The CEOôs remuneration should send the appropriate signal to the person, to the staff, and to other stakeholders.

Remuneration policy is influenced by many factors. Decision-makers usually do not know how much óweightô to give each factor, and are often reactive to situations that develop. Detecting environmental signs before others is what often gives the competitive advantage. Often, the driver is based primarily on what the committee can ósellô to shareholders, and hence may not be the most appropriate solution. Based on a sample of 148 prominent organisations, the top 5 factors that drive change to remuneration policy to a large extent in terms of recorded frequency are retention of key staff, financial results, strategic thrust, surveys/benchmarking and internal advisers. Corporate failures, investment/stock exchange analysts, publicity, governance/King II report, social upheaval/trade unions drive change to remuneration policy to a lesser extent (Bussin, 2008).

4.3. PERFORMANCE

How top directors and chief executives are being paid is also changing. More of the remuneration is being paid as bonuses. *"Five years ago the upper limit for annual bonuses was between 40% and 60% of base salary in most cases. By 2003, this had risen to100% in a third of cases, and more in others."* The same trend is evident in the granting of executive share options. However, there seems to be little indication that performance targets have been toughened to merit increases in bonus pay according to some reliable sources (Isles, 2006).

A salary is the incentive that motivates a person to do work in general - work that doesn't directly benefit the worker. In a very basic manner of speaking, if one desires someone else to meet these ends, he should logically give the latter at least as much money as the worker could have produced working for himself. That would be the situation in a very simple system, with a monopoly of one organisation on the market. If, however, there are two or more employers, then there is the element of competition, introduced into the system. The employees will have to offer a greater return to the worker if they want him to work for them instead of for the competition (Heskett, 2007).

The nature of work, whether it is hard work or work requiring rare skills, will determine the expectation the worker has for a larger compensation. High demand and low supply is another important factor. Past performance sometimes is more related to the team and environment than the person himself, therefore repeating past successes may not turn out to be that easy. *"Pay should be linked to performance, in my opinion, but we need to develop that magic formula in assessing that performance (percentage of personal contribution and percentage of team related factors) that will affect the bottomline and future growth of the company"* (Heskett, 2007).

5. THE CURRENT SITUATION

The current situation of CEO remuneration, as reflected in the annual reports of the companies previously defined, were analysed by means of certain statistical formulae for the financial years ending between July 2008 and June 2009. The average of CEO remuneration is also compared with the average of the Solidarity study of 2006. The CEO remuneration of 2006 and 2009 is then put into context with the market situation of the relevant periods, as reflected by various equity market indices.

5.1. REMUNERATION IN 2009

The racial and gender profile of the CEOǿs is shown in Table 2:

TABLE 2: RACIAL AND GENDER PROFILE OF CEO'S, 2009

Colour/Gender		Number	%
Black	Female	3	0.9%
Black	Male	32	9.8%
White	Female	2	0.6%
White	Male	221	67.8%
Unknown		68	20.9%
Total		**326**	**100%**

Table 2 shows that 67.8% of the CEOǿs are white males while 9.8% are black males. There were 1.5% female CEOǿs in total, 0.9% black and 0.6% white.

The statistical analysis of CEO remuneration is shown in Table 3:

TABLE 3: STATISTICAL ANALYSIS OF CEO REMUNERATION, 2009

	Total remuneration		Basic salary		Average
	Untrimmed	Trimmed	Untrimmed	Trimmed	All workers
Count	326	262	326	262	8,394,500
Average	R 4,760,937	R 3,666,252	R 2,372,408	R 2,093,945	R 124,457
Median	R 3,204,000	R 3,204,000	R 1,903,249	R 1,903,249	R -
Average deviation	R 3,373,556	R 1,747,329	R 1,276,675	R 768,582	R -
Minimum	R 16,000	R 1,057,000	R 16,000	R 395,000	R -
Maximum	R 93,700,297	R 9,192,000	R 19,305,000	R 8,476,000	R -
Bottom 25%	R 1,021,115	R 1,438,881	R 863,101	R 1,195,085	R -
Top 25%	R 11,333,949	R 6,674,202	R 4,416,756	R 2,995,307	R -
Average without parastatals	R 4,742,888	R 3,595,045	R 2,364,353	R 1,984,118	R -
Difference without parastatals	R -18,049	R -71,207	R -8,055	R -109,827	R -

According to Table 3, the average total CEO remuneration of all the companies studied was R4.76 million per annum. The highest remuneration for any of the companies was R93.7 million. The bottom 25% of all the companies paid their CEOôs R1.02 million on average per annum while the top 25% of the CEOôs were paid R11.33 million on average per annum. The average CEO remuneration of the trimmed group was R3.66 million per annum. The average basic salary of the CEOôs was R2.37 million per annum for the untrimmed group and R2.09 million for the trimmed group.

The average, excluding CEO remuneration of the parastatals, was R18 049.00 per annum less than the untrimmed average. The basic salary of this group makes only R8 055.00 difference to the untrimmed average.

The average CEO remuneration of the separate categories is shown in Table 4:

TABLE 4: AVERAGE CEO REMUNERATION OF SEPARATE CATEGORIES OF COMPANIES, 2009

Category	Number of Companies	Average basic salary	Average total remuneration	Basic as % of total remuneration
VENTURE CAPITAL	3	R 909,910	R 1,053,577	86%
DEVELOPMENT CAPITAL	4	R 798,702	R 1,269,452	63%
ALTX	67	R 1,169,751	R 1,672,659	70%
TECHNOLOGY	16	R 1,825,988	R 3,375,825	54%
INDUSTRIAL	66	R 2,245,375	R 4,389,585	51%
CONSUMER GOODS	21	R 2,946,756	R 4,485,411	66%
FINANCIALS	54	R 2,100,570	R 4,485,508	47%
PARASTATALS	16	R 2,528,476	R 5,110,629	49%
CONSUMER SERVICES	29	R 3,018,435	R 5,770,235	52%
HEALTH CARE	5	R 4,494,200	R 7,647,600	59%
RESOURCES	40	R 3,966,821	R 10,204,316	39%
OIL AND GAS	1	R 6,790,000	R 10,280,000	66%
TELECOMMUNICATIONS	4	R 5,115,000	R 11,456,111	45%
ALL COMPANIES	**326**	**R 2,372,408**	**R 4,760,937**	**50%**

Table 4 shows that on average, CEO remuneration within telecommunication companies are the highest, followed by Oil and Gas and then Resources. AltX, Development capital and Venture capital reflect the lowest CEO remuneration. On average the basic salary forms 50% of total remuneration, equal to the 50% of allowances and incentive bonuses. In the case of Resources, basic salary is only 39% of total remuneration. The higher the total remuneration, the lower the portion of basic salary, according to Table 4.

5.2. COMPARED TO 2006

The adapted average of this study, compared to the average of the Solidarity study, is shown in Table 5:

TABLE 5: COMPARISON BETWEEN CEO REMUNERATION, 2006 AND 2009

	Total remuneration		Basic salary	
	Untrimmed	Trimmed	Untrimmed	Trimmed
Average 2006	R 4,569,418	R 3,351,492	R 1,698,829	R 1,521,643
Average 2009*	R 5,720,291	R 4,505,136	R 2,748,524	R 2,428,250
Increase from 2006 to 2009	25.2%	34.4%	61.8%	59.6%
Basic as % of total 2006			37.2%	45.4%
Basic as % of total 2009			48.0%	53.9%

** Excluding Parastatals, AltX, Venture capital and Development capital to align with Solidarity's database.*

According to Table 5, the adapted average CEO remuneration for 2009 is R5.72 million per annum compared to the R4.57 million for 2006. This reflects an increase of 25.2%. The remuneration of the trimmed group increased by 34.4% from R3.35 million to R4.5 million. Basic salary of the untrimmed group increased by 61.8%, compared to 59.6% of the untrimmed group.

When the trimmed group is analysed, total remuneration consist of 45.4% basic salary in 2006 and 53.9% in 2009. In the case of the untrimmed group, basic salary as a component of total remuneration, increased by 11 percentage points. This means that allowances and bonuses formed 63% of total remuneration in 2006 and decreased to 52% in 2009.

5.3. MARKET CONDITIONS

The variable portion (mainly performance bonuses) of CEO remuneration, together with the performance of the JSE all share index and the South African economy, is shown in Figure 1:

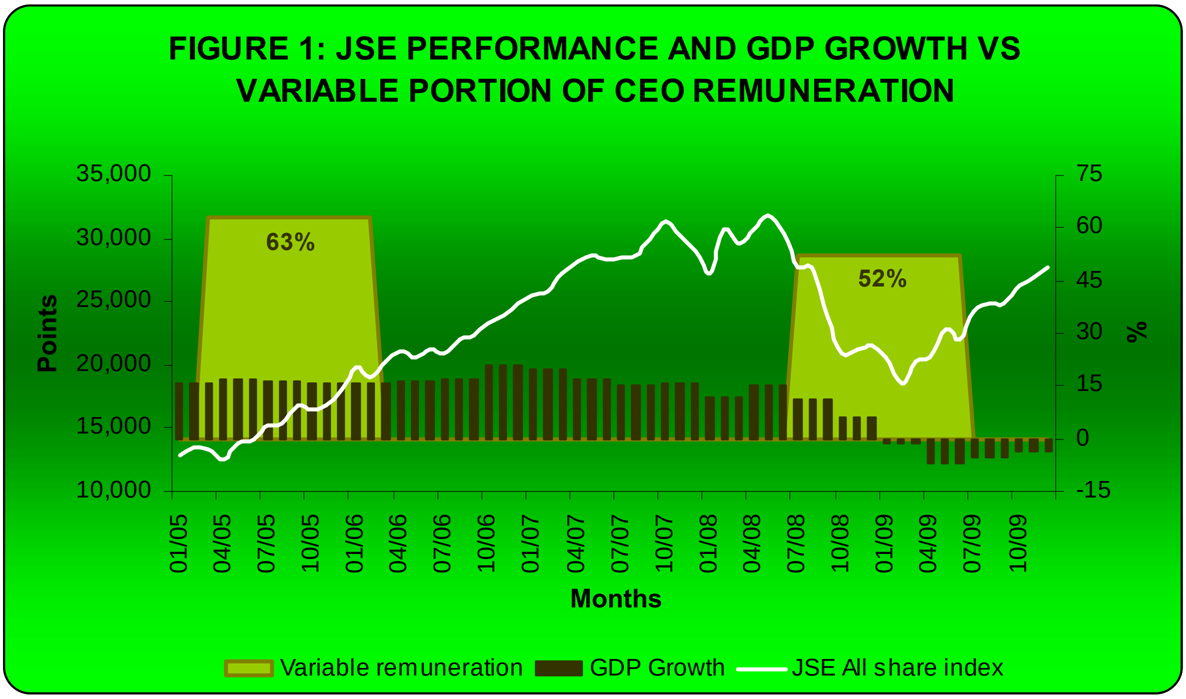


FIGURE 1: JSE PERFORMANCE AND GDP GROWTH VS VARIABLE PORTION OF CEO REMUNERATION

According to Figure 1, the higher portion of 63% of variable CEO remuneration in 2006 coincided with a bullish period of share prices on the JSE as well as a prosperous period in economic growth. In 2009, when the JSE experienced a very significant bear market that coincided with a severe economic recession, the variable portion of CEO remuneration dropped to 52%. It therefore appears that the variable portion of CEO remuneration is positively linked to the performance of the JSE. The JSE lost 42% of its value from its highest value in May 2008 to its lowest value in February 2009. It lost 22% over the analysed period of this study from July 2008 to June 2009.

The JSE all share index performance, compared to the performance of major international equity markets, is shown in Figure 2:

FIGURE 2: JSE PERFORMANCE VS OTHER EQUITY MARKETS

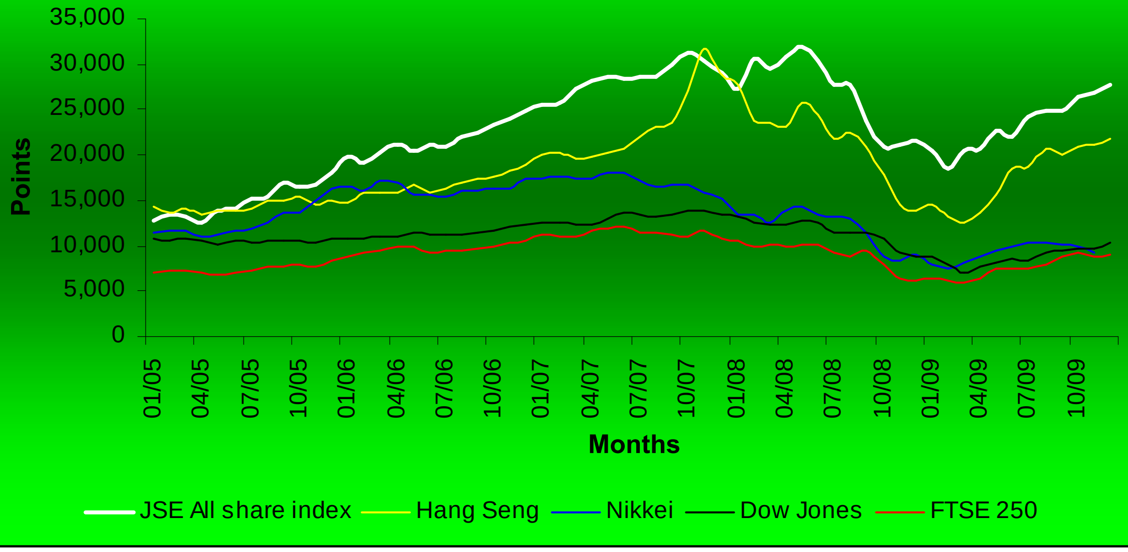


Figure 2 shows that there is a direct correlation between the performance of the JSE to that of the major equity markets around the globe. They all experienced a bull phase during 2005 and they all slumped quite significantly at the end of 2008. As in the case with all the major markets, the JSE (as a follower of international trends) also recovered from the middle of 2009 onwards. In the context of Figure 1, it can therefore be argued that almost 50% of CEO remuneration packages of South African companies is positively linked to the performance of international equity markets.

5.4. CONCLUSION

White males represent 67,7% of CEOÕs in South African companies, while 9.8% are black males. In total 1.5% CEOÕs are female.

The average total CEO remuneration of all the companies studied was R4.76 million per annum. The average CEO remuneration of the trimmed group was R3.66 million per annum. The average basic salary of the CEO□s was R2.37 million per annum for the untrimmed group and R2.09 million for the trimmed group.

Remuneration of the untrimmed group of CEO□s increased by 25.2% from 2006 to 2009 while that of the trimmed group increased by 34.4%. The basic salary of the untrimmed group of CEO□s increased by 61.8%, compared to 59.6% of the untrimmed group. In the case of the untrimmed group, basic salary as component of total remuneration increased by 11 percentage points. This means that allowances and bonuses formed 63% of total CEO remuneration in 2006 and decreased to 52% in 2009.

It appears that the variable portion of CEO remuneration is positively linked to the performance of the JSE as the higher portion of 63% of variable CEO remuneration in 2006 coincided with a bullish period of share prices on the JSE while in 2009, when the JSE experienced a very significant bear market, the variable portion of CEO remuneration dropped to 52%. This coincided with a drop of 22% in the value of the JSE as well as a deep recession in the South African economy. So on average, even during severe negative economic periods, CEO□s can still count on doubling their annual remuneration with performance bonuses that will be at least equal to the value of their ever-increasing annual basic salary.

6. COMPARISON WITH OTHER SALARIES

Reflecting on the level of CEO remuneration, without placing it in perspective with other remuneration packages, is meaningless. The problem is finding similar levels of responsibility or hierarchy of decision-making to compare the position of a CEO meaningfully. For the purpose of this study the remuneration packages of public office bearers and the salaries and benefits of employees in the public service, were used as a comparison. CEO remuneration was compared with the average earnings of all employees as determined by Stats SA for employment in the formal non-agricultural business sector. Changes in the ratio between CEO remuneration and average earnings since the Solidarity study, are reflected in this section.

6.1. CEO REMUNERATION AND OTHER SALARIES

The remuneration packages of certain public office bearers, the highest and lowest salaries and benefits of employees in the public service and the average earnings of all employees are compared with CEO remuneration in Table 6:

TABLE 6: COMPARISON BETWEEN CEO REMUNERATION AND VARIOUS OTHER REMUNERATION PACKAGES, 2006 AND 2009

Category	Note	2006	2009	Increase over 3 years	Increase average pa
Exclusive:	1				
Trimmed Remuneration		R 3,351,492	R 4,505,136	34.4%	11.5%
Trimmed Basic salary		R 1,521,643	R 2,428,250	59.6%	19.9%
Inclusive:	2				
Trimmed remuneration		R -	R 3,666,252	-	-
Average worker	3	R 85,140	R 124,457	46.2%	15.4%
Government salaries:					
President	4	R 1,117,199	R 1,898,400	69.9%	23.3%
Minister	4	R 836,827	R 1,452,300	73.5%	24.5%
Member: National Assembly	4	R 426,811	R 643,800	50.8%	16.9%
Premier	4	R 828,785	R 1,366,900	64.9%	21.6%
Chief Justice	4	R 728,128	R 1,708,600	134.7%	44.9%
Judge: High/Labour court	4	R 650,500	R 1,110,600	70.7%	23.6%
Executive mayor	4	R 639,342	R 756,900	18.4%	6.1%
Director general (Level 12 Maximum)	5	R 374,694	R 472,758	26.2%	8.7%
Cleaner (Level 1 Minimum)	5	R 34,107	R 42,663	25.1%	8.4%

1. Excluding Parastatals, AltX, Venture capital and Development capital to align with Solidarity's database.

2. Including Listed companies, Parastatals, AltX, Venture capital and Development capital

3. Source: Stats SA

4. Source: The independent commission for remuneration of public officer bearers

5. Source: Department of Public Service and Administration

According to Table 6, the average CEO remuneration of the trimmed group was R3.35 million in 2006 and increased by 34.4% to R4.5 million in 2009. The total earnings of the average worker was R85 140.00 in 2006 and increased by 46.2% to R124 457.00 in 2009. On average, CEO remuneration increased by 11.5% per annum while that of the average worker increased by 15.4% per annum. The average basic salary of CEOôs increased by 19.9% per annum.

The President of South Africa earns R1.89 million per annum while the remuneration package of a provincial premier is R1.36 million. Their earnings increased by 23.3% and 21.6% per annum respectively since 2006. The maximum level of remuneration for a director general is fixed on R472 758.00 per annum for 2009. This is 26.2% more than what it was in 2006. A cleaner on the lowest earnings level in the public service earned R42 663.00 per annum in 2009.

6.2. RATIOS

The ratio between CEO remuneration and that of certain public office bearers, employees in the public service and the average earnings of all employees is shown in Table 7:

TABLE 7: THE RATIO BETWEEN CEO REMUNERATION AND VARIOUS OTHER REMUNERATION PACKAGES, 2006 AND 2009

Category	Exclusive* trimmed		Inclusive** trimmed
	2006	2009	2009
CEO Remuneration	**R 3,351,492**	**R 4,505,136**	**R 3,666,252**
Ration with CEO remuneration:			
Average worker	39	36	29
President	3	2	2
Minister	4	3	3
Member: National Assembly	8	7	6
Premier	4	3	3
Chief Justice	5	3	2
Judge: High/Labour court	5	4	3
Executive mayor	5	6	5
Level 12 (Maximum)	9	10	8
level 1 (Minimum)	98	106	86

** Excluding Parastatals, AltX, Venture capital and Development capital to align with Solidarity's database.*

*** Including Listed companies, Parastatals, AltX, Venture capital and Development capital*

Table 7 shows that the average remuneration of the trimmed group of CEOôs in 2006 was 39 times more than that of the average worker. This ratio decreased to 36 times in 2009. When the same calculation is done with the average basic salary of CEOôs, the ratio increased from 18 in 2006 to 20 in 2009. The decreasing ratio of total remuneration is therefore the result of a decrease in the variable portion (mainly performance bonuses) of the CEOôs in 2009.

Except for executive mayors, public office bearers gained on their ratios with CEOôs from 2006 to 2009 while the CEOôs gained on public service workers over the same period. CEOôs (exclusive database) earned ten times more then a director general in 2009 while they earned 106 times more than a cleaner in the public service for the same year. In 2006 the ratios were 9 times and 98 times respectively.

6.3. TIME AS A FACTOR

The effect of time on CEO remuneration is shown in Table 8:

TABLE 8: EFFECT OF TIME ON REMUNERATION, 2009

	CEO's		Average worker
	Untrimmed	Trimmed	
Number of CEO's earning:			
R1.5 m and more per annum	255	223	-
R12 m and more per annum	19	0	-
How long to earn R1 million	2.5 months	3.3 months	8 years

Table 8 shows that 255 of the untrimmed group of CEOôs earned more that R1.5 million in 2009. This means that these CEOôs earned R125 000.00 per month, which is just more than the average annual earnings of R124 457.00 for workers in South Africa during the same period. In other words, 78% of the CEOôs earned more in a month than the average worker earned in a year.

There were nineteen of the CEOôs (6%) that earned more than R1 million in a month. In 2009, it took only three months on average for a CEO to earn R1 million, while it would take the average worker eight years to earn the same amount with an average salary of R124 457.00.

6.4. CONCLUSION

The average remuneration of CEOôs of the trimmed group was R3.35 million in 2006 and increased by 34.4% to R4.5 million in 2009. The total earnings of the average worker was R85 140.00 in 2006 and increased by 46.2% to R124 457.00 in 2009. On average, CEO remuneration increased by 11.5% per annum while that of the average worker increased by 15.4% per annum. The average basic salary of CEOôs increased by 19.9% per annum.

The President of South Africa earns R1.89 million per annum while the remuneration package of a provincial premier is R1.36 million. Their earnings increased by 23.3% and 21.6% per annum respectively since 2006. The maximum level of remuneration for a director general is fixed on R472 758.00 per annum for 2009. A cleaner on the lowest earnings level in the public service earned R42 663.00 per annum in 2009.

The average remuneration of CEOôs was 39 times more in 2006 than that of the average worker. This ratio decreased to 36 times in 2009. The ratio of average basic salary of

CEOôs increased from 18 in 2006 to 20 in 2009. The decreasing ratio of total remuneration is therefore the result of a decrease in the variable portion (mainly performance bonuses) of the CEOôs in 2009.

Except for executive mayors, public office bearers gained on their ratios with CEOôs from 2006 to 2009 while the CEOôs gained on public service workers over the same period. CEOôs earned ten times more then a director general in 2009 while they earned 106 times more than a cleaner in the public service for the same year. The same ratios are 9 times and 98 times respectively for 2006.

78% of the CEOôs earned more in a month than what the average worker earned in a year. In 2009, it took only three months on average for a CEO to earn R1 million while it would take the average worker eight years to earn the same amount with an average salary of R124 457.00.

7. TAKING BUSINESS FACTORS INTO ACCOUNT

As shown in the previous section, there is a significant difference between the remuneration of CEOôs and that of other earnings packages. The important question that therefore remains to be answered is if this huge gap can be justified? In this section the correlation between CEO remuneration on the one hand will be determined by performance, company size, the value added to shareholders capital and chairpersonôs remuneration on the other hand.

The CEO remuneration values of the trimmed group were sorted in ascending order and the various measurements were plotted together with CEO remuneration on a graph. A linear trend line was added to graphically display trends in data. A linear trend line usually shows that something is increasing or decreasing at a steady rate. As a summary, the correlation coefficient was also calculated for the various measurements and presented in a table.

The correlation tools are used to determine whether two ranges of data move together. That is, whether large values of one set are associated with large values of the other (positive correlation), whether small values of one set are associated with large values of the other (negative correlation), or whether values in both sets are unrelated (correlation near zero).

7.1. PERFORMANCE

Performance can be measured by profit and by growth in turnover. The profit of the current year is shown in correlation with CEO remuneration in Figure 3:

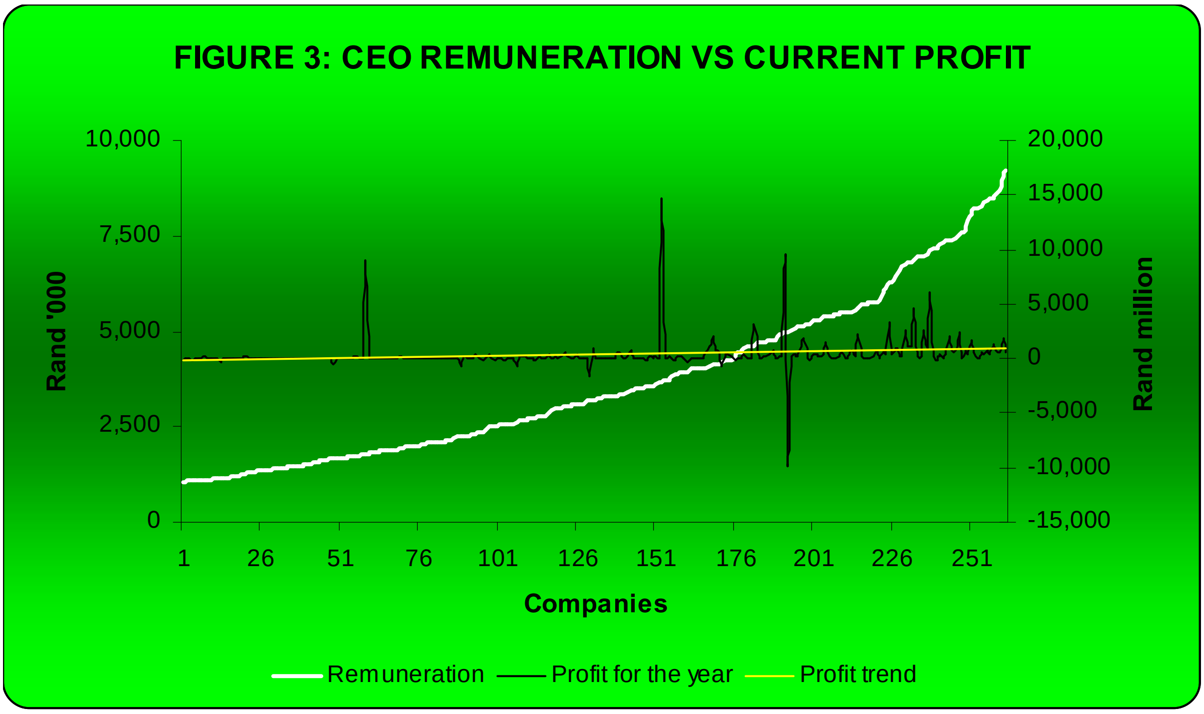


Figure 3 shows that the profit of the current year doesnôt correlate with CEO remuneration. CEO remuneration of the companies increases regardless of an increase in the current year’s profit of the companies.

It could be that CEO remuneration is linked to the profit of the previous year. The profit of the previous year is shown in correlation with CEO remuneration in Figure 4:

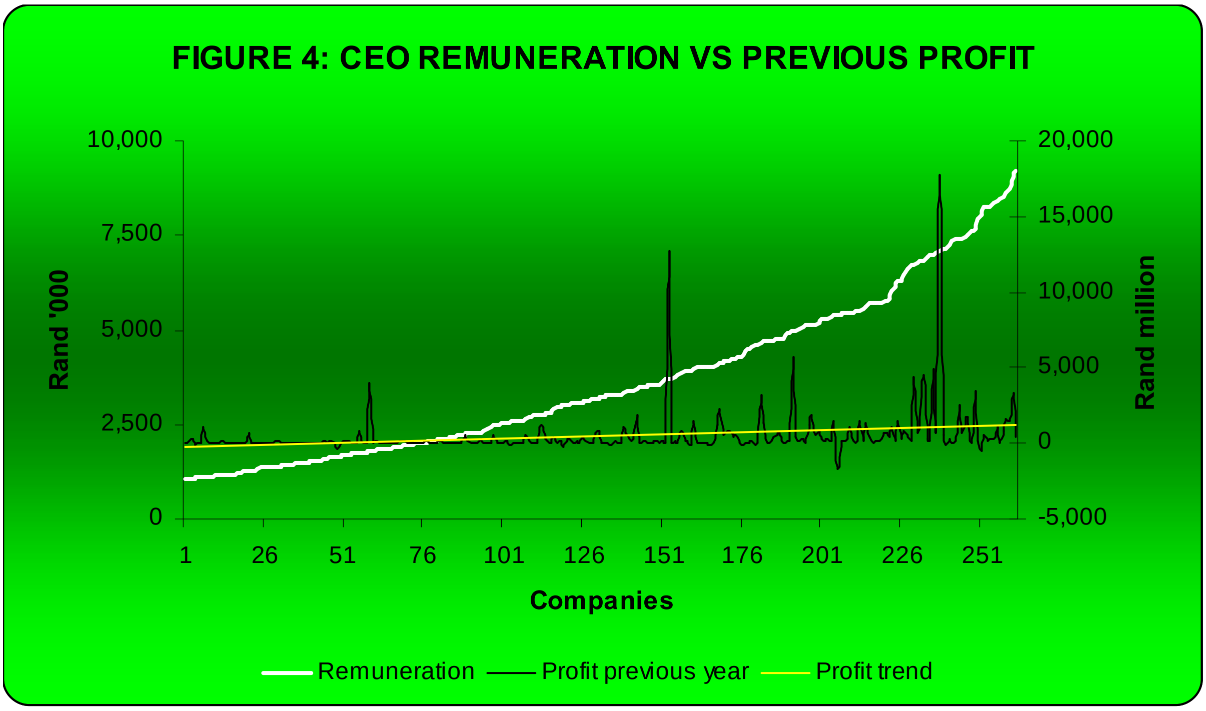
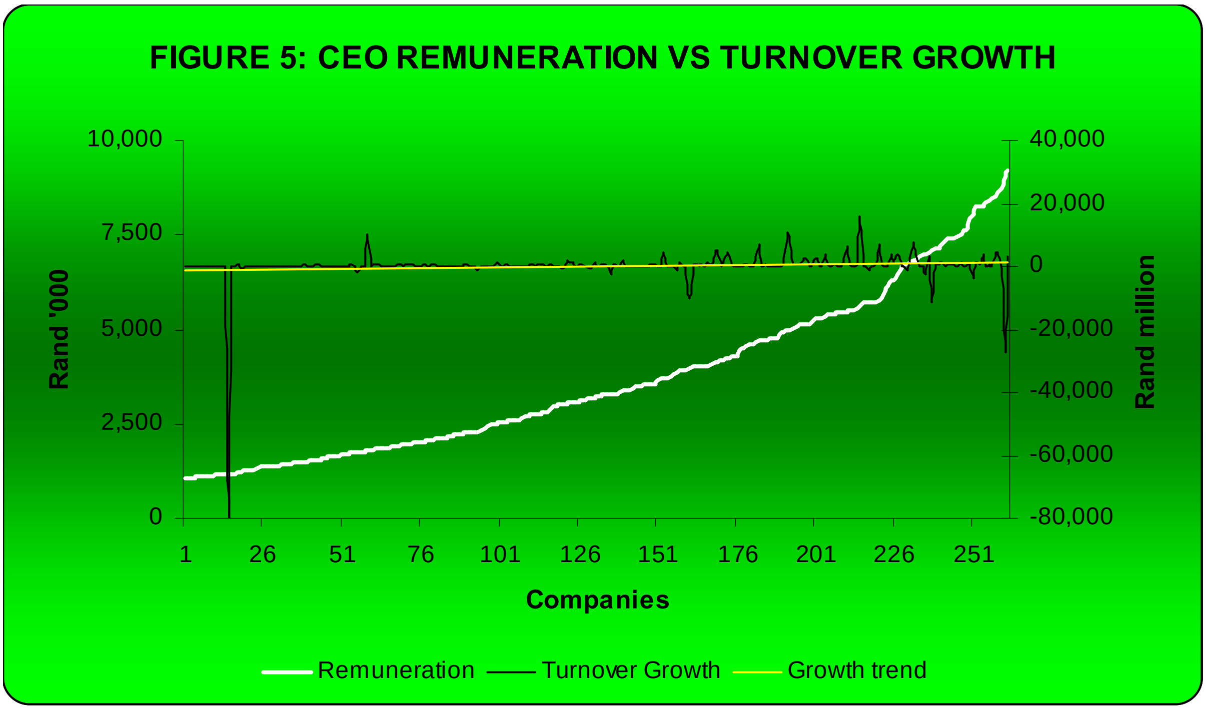


FIGURE 4: CEO REMUNERATION VS PREVIOUS PROFIT

Figure 4 shows that the profit of the previous year doesn’t correlate with CEO remuneration. CEO remuneration of the companies increases regardless of an increase in the previous year’s profit of the companies.

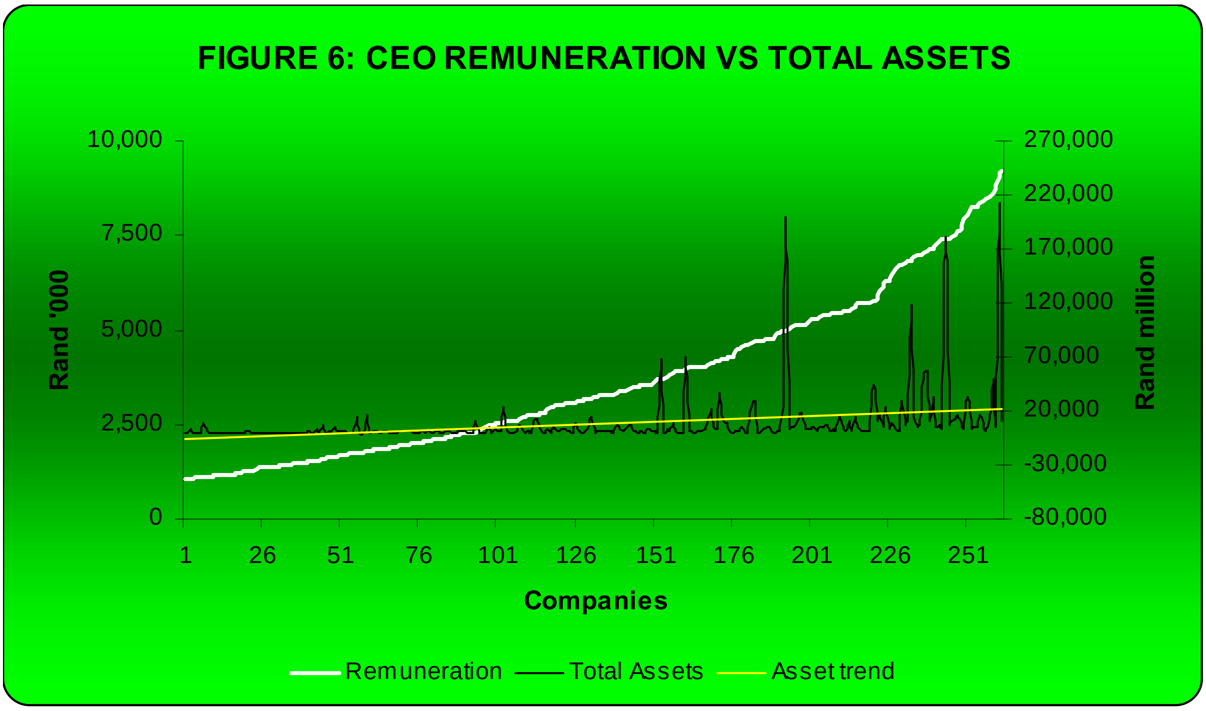
As mentioned, performance can also be measured by growth in turnover. The growth from 2008 to 2009 is shown in correlation with CEO remuneration in Figure 5:



According to Figure 5, there is also no correlation between CEO remuneration and growth in turnover. CEO remuneration increased steadily without the same steady increase in turnover.

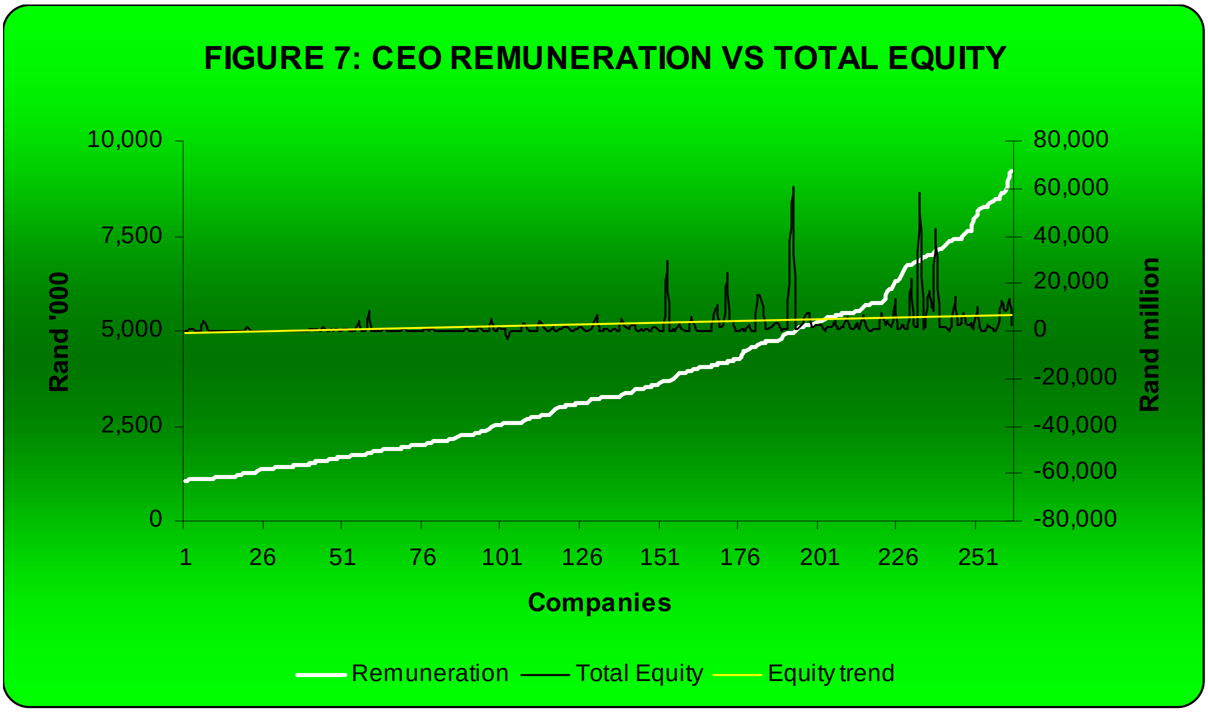
7.2. A MATTER OF SIZE

Company size can be measured by means of total assets, total equity and turnover. The value of total assets of the companies is shown in correlation with CEO remuneration in Figure 6:



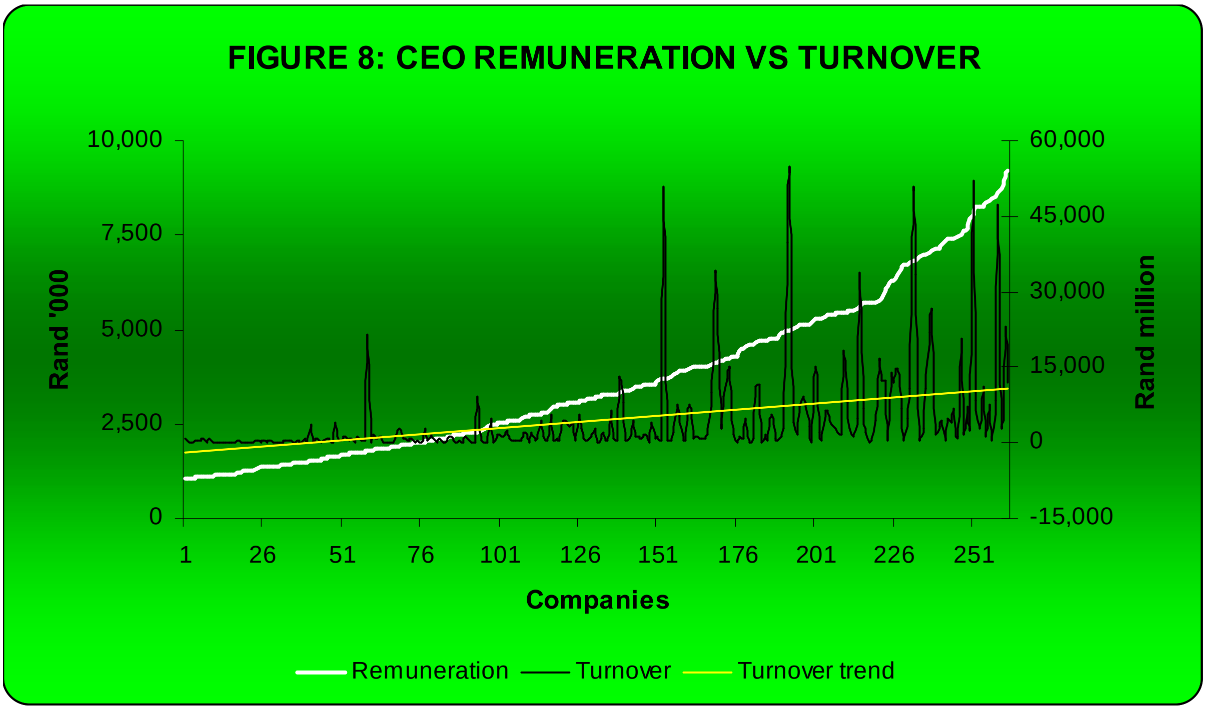
According to Figure 6, there is a very slight, but by no means convincing, correlation between the value of total assets of the companies and the CEO remuneration of the companies.

The value of total equity of the companies is shown in correlation with CEO remuneration in Figure 7:



As in the case of total assets, Figure 7 shows that there is a very slight, but not convincing, correlation between the value of total equity of the companies and their CEO remuneration.

The total turnover of the companies is shown in correlation with CEO remuneration in Figure 8:



According to Figure 8, there is indeed a correlation between the turnover of the companies and the CEO remuneration. As will be shown later, however, it is still not a very strong correlation.

7.3. ADDING VALUE

With company performance or company size not a very convincing measurement for the size of CEO remuneration, it could be that the CEOôs ability to add value to shareholders capital (total equity) is the determining factor of CEO remuneration. The ratio of current profit to equity is shown as a correlation to CEO remuneration in Figure 9:

FIGURE 9: CEO REMUNERATION VS EQUITY/CURRENT PROFIT RATIO

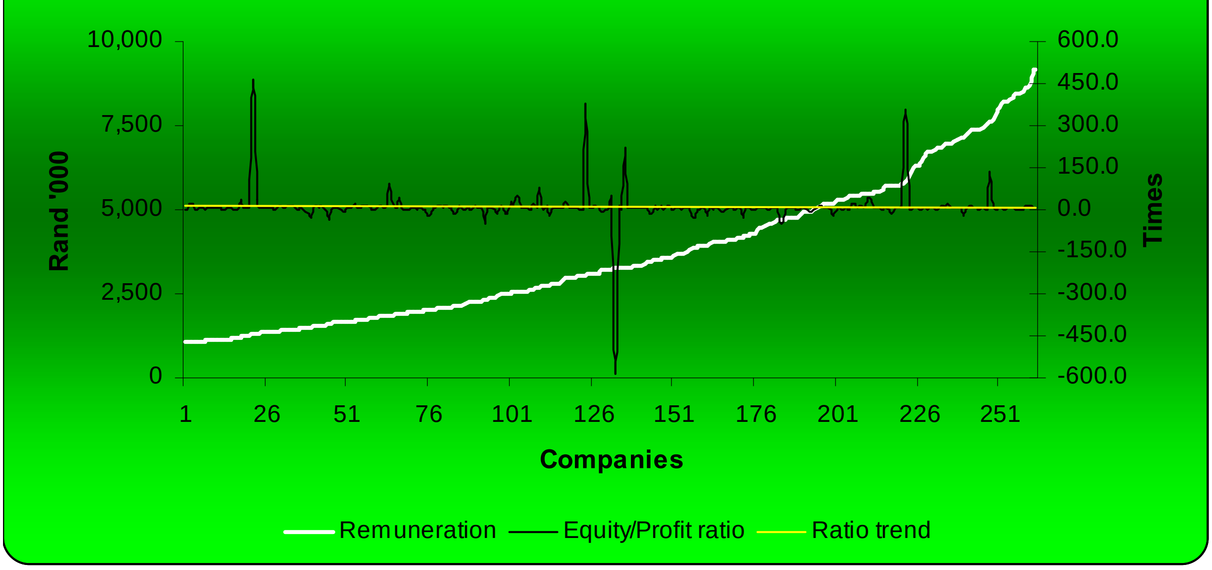
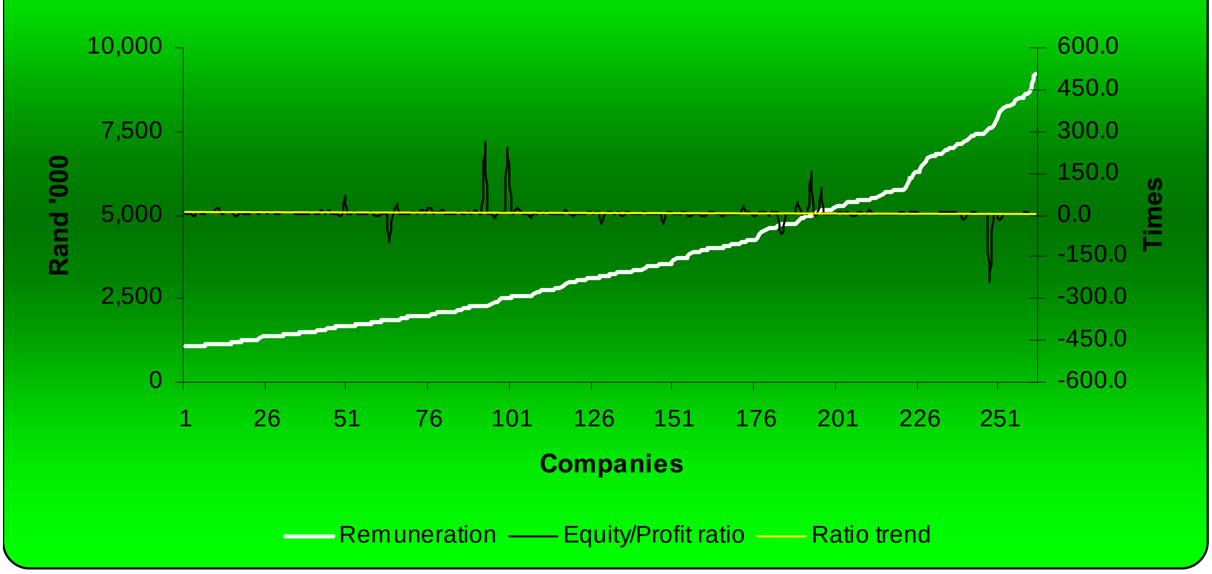


Figure 9 shows that there is a slim negative correlation between the current equity/profit ratio and CEO remuneration.

As in the case of profit alone, it could be that CEO remuneration is determined by the profit of the previous year as basis. Therefore, the ratio of previous profit to equity is shown as a correlation to CEO remuneration in Figure 10:

FIGURE 10: CEO REMUNERATION VS EQUITY/PREVIOUS PROFIT RATIO



According to Figure 10, the negative correlation between the equity/profit ratio is even bigger in the previous yearôs profit than with current profit.

7.4. THE CHAIR'S CALL

It could be that the chairperson has the final say in CEO remuneration. The remuneration of the chairperson of the companies is shown in correlation with CEO remuneration in Figure 11:

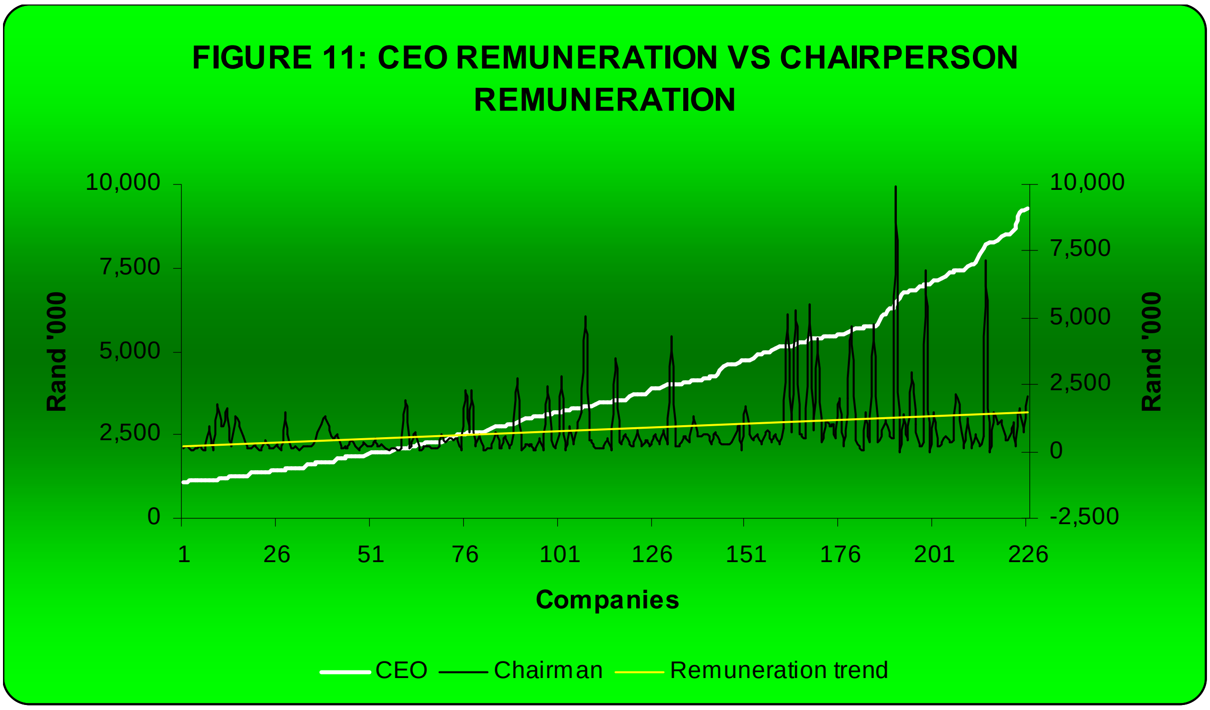


Figure 11 shows that the remuneration of the chairperson doesnôt correlate with CEO remuneration.

7.5. CONCLUSION

As represented in the graphs, there is no convincing factor regarding company performance or size or the ability of the CEOôs to add value to equity. Not even the correlation with the remuneration of the chairperson, which can be argued as a determinant of CEO remuneration, can add value to equity. The use of the correlation coefficient confirms it, as summarised in Table 9 and sorted by descending order:

TABLE 9: CORRELATION BETWEEN CEO REMUNERATION AND VARIOUS BUSINESS FACTORS, 2009

Meassurement	Correlation with CEO remuneration
Turnover	0.43
Total Assets	0.36
Total Equity	0.32
Chairperson's remuneration	0.27
Profit previous year	0.27
Profit for the year	0.20
Turnover Growth	0.08
Equity/Profit ratio	-0.01
Equity/Previous profit ration	-0.11
Variable protion of remuneration	0.63

In the case of the correlation coefficient, a value of 1 indicates a very positive correlation, a value of 1- a very negative correlation and a value of 0, no correlation. According to Table 9, turnover shows the strongest correlation with CEO remuneration, followed by the value of total assets and equity. There is no logical explanation how turnover on its own can be a determinant of CEO remuneration.

None of the values in Table 9 are above 0.5, and not even close to 1 where it could be considered a strong correlation. The measurements of company size, seems to have more of an influence on CEO remuneration than that of the performance indicators, namely profit, turnover growth or equity/profit ratio at the bottom of the list.

As indicated by the trend lines in the graphs, the correlation coefficient also confirms that performance of the individual companies is by no means a determinant of CEO remuneration. Although slightly stronger, there is also no convincing indication that company size is a determinant of CEO remuneration. Therefore, no single business factor emerged as the main determinant of CEO remuneration.

Added to the bottom of Table 9 is the correlation of the variable portion of remuneration with total remuneration. The value of 0.63 shows a firm correlation between the size of the remuneration package and the variable portion of the remuneration. In other words, the higher the total remuneration of a CEO becomes, the portion of performance bonus it contains increases, although no performance measurement correlates positively with CEO remuneration.

8. THE REAL DRIVERS OF REMUNERATION

The fact that CEO remuneration is not really linked to business factors is confirmed by at least two other sources. Vermeulen (2008) argued very strongly: *"...there has been quite a bit of research that has tried to show that CEO compensation is tied to firm performance. It ain't. That research has tried, has tried hard and harder, but just could not deliver much evidence that CEO remuneration is determined by firm performance. Admittedly, some studies have uncovered some minor positive relations between pay and performance but it wasn't much. The only economic factor that has delivered some consistent results worth mentioning – indicating a positive influence on CEO pay – is firm size: bigger firms pay better. Although this may be an intuitive result, it is actually not that clear why... But anyway, we have found one thing that seems to explain top executive pay, so let's not be too critical about it but accept it with grace."*

PriceWaterhouseCoopers (2010) is of the opinion that there is little relationship between CEOÕs payment and company performance. They added that other, less rational factors overwhelm it. In this section, these Ôless rational factorsÕ will receive more attention. The influence of share options, the principal/agent relationship between shareholders and the CEO, the role of the remuneration committee and the Lake Wobegon effect will be discussed.

8.1. SHARE OPTIONS

The findings of the inquiry by the Australian government reflect in all possibility the South African situation as well. According to this report, the remuneration structure is mainly accountable for the rapid growth in executive remuneration in Australia (Australia, 2009):

- Greatly increased scale of many Australian companies, accompanied by heightened competition for the best executives, appears to explain around one-third of observed changes.
- Increased globalisation has also led to executive remuneration being influenced by overseas trends, including the ÔimportationÕ of incentive remuneration structures from the United States in the 1990Õs. Increased use of incentive remuneration has been a major contributor to remuneration growth.
- Board weakness is likely to have been a factor in instances of apparent Ôrewards for failureÕ, while complex remuneration structures are likely to have yielded higher payments than anticipated in some cases.

The USA is also blaming the fundamental changes in the global economy for the pronounced changes in executive remuneration practices. The remuneration for CEOÕs in large US companies increased dramatically over the past three decades, driven by an explosion in grants of share options. (Jensen *et al*, 2004)

The ability of executives to obtain higher remuneration, however, is limited by so-called ÔoutrageÕ costs and constraints; that is, negative reaction by shareholders, the business media and others, which can lead to reputational embarrassment for executives and company directors. To extract higher pay, executives (and compliant boards) therefore will seek to ÔcamouflageÕ their remuneration arrangements to limit external scrutiny. Bebchuk and Fried (2003) contend that US executive remuneration rose significantly from the 1990s because:

- Executives used their influence to obtain significant amounts of option remuneration without forgoing corresponding amounts of cash remuneration;
- Options were not tightly linked to the performance of executives, allowing them to óreap windfallsô from movements in share prices that were due to market and industry trends beyond their control (ôpay for good luckö);
- The rising share market of the 1990ös provided a ôconvenient justificationô for increases in remuneration at many companies (even relatively poorly performing ones) due to the long-established correlation between remuneration and company size;
- óOutrage costsô and constraints were also weakened in the market boom, with shareholders less likely to scrutinise generous remuneration arrangements;
- Termination and other deferred remuneration and company loans could be ôhiddenö.

As previously shown in Figures 1 and 2, several of the above viewpoints argued by Bebchuk and Fried is in all possibility also applicable on South African companies. Individual share prices are probably closely linked to JSE performance, which in turn is closely linked to the performance of international equity markets, more than the profit or turnover growth of the companies itself. The question to be answered when rewarding performance is whether it is a great company or a growing industry being rewarded?

The assumption is that the company is well managed and performing close to the expected benchmark, although not necessarily performing exceptional within the relevant category of companies. In other words, there is a certain demand for shares regardless of the CEOös unique talent or scarcity. When a large portion of remuneration is linked to share price performance in general and not to the individual companyös performance, it singles out the CEO óto reap windfallsô or ôpay for good luckô at the expense of the company. The CEO, like everybody else in his company, should be doing his job without any incentive, namely managing the company well.

8.2. THE PRINCIPAL/AGENT PROBLEM

The principal/agent problem or agency dilemma treats the difficulties that arise under conditions of incomplete and asymmetric information, when a principal hires an agent for performing certain acts that are useful to the principal and costly to the agent. The problem is that the two may not have the same interests, while the principal is, presumably, hiring the agent to pursue the interests of the former. The principal/agent problem is found in most employer/employee relationships, for example, when stockholders hire top executives of corporations (Wikipedia, undated).

With the advent of the industrial revolution, businesses grew from entities owned and managed by the same person, into large corporations where owners (shareholders) and management (CEOös) are separate role-players. Performance-based remuneration, often in the form of share options, was endorsed by researchers throughout the world as a way of aligning the interests of the shareholders and the agents (CEO's) who act on behalf of the shareholders (Scholtz, 2008).

If the manager of a company owned 100 percent of the company's shares, then (risk aversion and self control problems aside) the decisions made by that manager would be presumed to be those that maximize long-run shareholder value, and there would be no need for additional incentive plans. However, decisions in companies are not made by owners but rather by managers who hold far less than 100 percent of the company's stock. These managers, although hired for their expertise and managerial talent, cannot be expected to make the same decisions as the owners would have made themselves. This 'agency problem' is especially prevalent for decisions that are personally costly for managers (such as decisions to layoff employees and sell divisions or the entire company) because the managers bear a disproportionate share of the cost vs. benefits, and for decisions that benefit managers (such as buying corporate aircraft or remodelling the corporate headquarters) because the managers reap a disproportionate share of the benefits vs. cost (Jensen *et al*, 2004).

Separating investors' ownership from specialised managerial control can create the potential for divergence of interests between owners and managers, creating a 'principal/agent problem'. Executive remuneration is one area where the divergence between the interests of managers and owners has the potential to become especially acute (Australia, 2009).

Remuneration decisions are not made by owners but rather by boards of directors (upon recommendation from the remuneration committees). In addition, remuneration committees routinely lack the information, expertise and negotiating skills necessary for hard-nosed contract negotiations with incumbent and incoming executives. As a result, many earnings packages and processes are poorly designed. Therefore earnings packages can create, as well as reduce, agency problems in organisations by attracting the wrong managers (at too high a cost), or retaining the wrong managers, and motivating the wrong behaviour. Because managers serve their own interests, and because remuneration committee members are spending the company's resources and not their own, there is major potential for the participants in the system to behave in ways that will exacerbate, not reduce, agency problems. As a result, executive contracts are almost inevitably tilted towards the benefit of top executives (Jensen *et al*, 2004).

8.3. THE REMUNERATION COMMITEE

For public companies, the board of directors, specifically the 3-5 outside directors that serve on the remuneration committee, determine CEO remuneration. Research on the relation between CEO remuneration and boards of directors was done by Charles O'Reilly and Graef Crystal from the University of California in Berkeley and Brian Main from the University of St. Andrews. They studied 105 large American companies and first computed the relation between a number of economic factors (such as company performance and size) and CEO remuneration. The only thing they found with a connection was between company turnover and CEO remuneration. Then, O'Reilly, Crystal and Main realise that the directors on these committees are usually CEO's or ex-CEO's themselves. Therefore, they compared the salaries of these director CEO's to the salaries of the CEO's of the companies for which they served on the remuneration committee and discovered a strong relationship between them. They argued that this association could only be the result of some sort of psychological social comparison process. The directors on the remuneration committee who decide on the CEOøs salary simply determine his remuneration by looking at what they themselves earn at their own companies. And thus, doing this, they donøt feel restricted by irrelevant issues such as the companyøs actual performance during the tenure of the CEO (Vermeulen, 2008).

Vermeulen (2008) elaborates on the above: *"... who do you think determines who gets asked to serve as an outside director for a firm...? Any guesses...? Yep, it's usually a company's CEO who generally nominates new outside directors. That does make it rather tempting for a CEO to be rather selective about which peers you nominate to serve as director and determine your compensation packages, doesn't it...? Since, according to Charles, Graef and Brian's research, their wealth may nicely domino into your bank account. The last people you want on your board are those guys who are on a meagre package themselves; because they would likely curb your dosh as well. Instead, bring in the rich guys; they'll make you rich too!"*

Vermeulenøs view is echoed by PriceWaterhouseCoopers (2010): *"If you want to make a lot of money, pick the richest and most highly paid people you can find to set your salary."*

According to Jensen (*et al,* 2004), remuneration committee members approach their jobs with good intentions, intelligence, and integrity, but are not as diligent as they would be if they were spending their own money. Remuneration committees, which typically meet only six to eight times a year, lack both the time and expertise to be involved in the minutia of performance evaluation and remuneration design. The fact that initial recommendations are made by company management and not by the remuneration committee may be an efficient outcome given the time and resource constraints faced by the committee, but it calls to question the integrity of the remuneration process. The fact that the committee only sees plans that have already been õblessedö by top managers creates an environment that invites abuse and bias. Put differently, although individual committee members are generally competent and well motivated, the governance system itself is corrupted and tilted in the direction of management in a way that will almost inevitably lead to excesses in executive remuneration levels. (Jensen *et al*, 2004)

8.4. THE LAKE WOBEGON EFFECT

In what has been termed *"The Lake Wobegon effect"* after the books by humorist Garrison Keillor, academics Scott Schaefer and Rachel Hayes have argued that companies fell into a vicious cycle when paying their CEOøs, seeing the odds or risk of their share price plummet. In Keillorøs fictional hometown of Lake Wobegon, all children are óabove averageô.

Schaefer and Hayes (2007) argue that something similar happened in the business world in relation to CEO remuneration over the past few years. In essence, companies had to pay ever-higher salaries to convince investors their CEO was above average, while investors expected to see these high salaries to give themselves something to believe (and therefore invest) in. No organisation wanted to admit to having a CEO who was below average, and therefore no company allowed its CEO remuneration package to lag behind market expectations.

"Everyone knows that in well-functioning labor markets, better performers earn higher salaries," Schaefer pointed out. ñ*So if a company hired a CEO and paid a low salary of, say, $1 million a year, investors might simply conclude he or she wasn't great CEO material and downgrade the company's stock. But if the company decided to pay its bargain basement CEO as if he or she was a superstar, investors were more likely to conclude a superstar was leading the organisation and therefore push the share price higher."*

Heskett (2007) argues that many remuneration packages are determined on the basis of what others in comparable jobs, regardless of performance, are being paid. This creates a natural disconnect between pay and performance (Heskett, 2007). The Australian government Inquiry report (Australia, 2009) agrees: *"Some participants argued that public disclosure of individuals' pay triggered a pay spiral, as companies and executives sought to 'position' themselves in the market, with no one wishing to be seen as hiring or being a 'below average' executive."*

The Wobegon effect is probably the best described by the man who motivated Schaefer and Hayes to formulate their model, namely former DuPont CEO Edward S. Woolard, Jr.: *"The main reason (CEO) compensation increases every year is that most boards want their CEO to be in the top half of the CEO peer group, because they think it makes the company look strong. So when Tom, Dick, and Harry receive compensation increases in 2002, I get one too, even if I had a bad year.... (This leads to an) upward spiral"* (In Schaefer and Hayes, 2007)

8.5. CONCLUSION

CEO remuneration increased dramatically over the past three decades, driven by an explosion in grants of share options. Options are not tightly linked to the performance of CEOôs, allowing them to benefit from movements in share prices that were due to market and industry trends beyond their control. When a large portion of remuneration is linked to share price performance in general and not the individual companyôs performance, the CEO reaps the benefits at the expense of the company while he is doing what he is in any case suppose to be doing, namely managing the company well.

Performance-based remuneration, often in the form of share options, was endorsed by researchers throughout the world as a way of aligning the interests of the shareholders and the agents (CEOôs) who act on behalf of the shareholders. The principal/agent problem treats the difficulties that arise under conditions of incomplete and asymmetric information. The problem presented is the two may not have the same interests, while the principal is, presumably, hiring the agent to pursue the interests of the former. CEO remuneration is therefore an area where the divergence between the interests of managers and owners has the potential to become especially acute.

There are strong arguments that the directors on the remuneration committee, who decide on the CEOôs remuneration, simply determine his remuneration by looking at what they themselves earn at their companies. Although remuneration committee members approach their jobs with good intentions, intelligence, and integrity, they are not as diligent as they would be if they were spending their own money. The committee in fact only sees plans that have already been ˝blessedˆ by top managers and although individual committee members are generally competent and well motivated, the governance system itself is corrupted and tilted in the direction of management in a way that will almost inevitably lead to excesses in the remuneration levels of CEOˆs.

Many remuneration packages are determined on the basis of what others in comparable jobs, regardless of performance, are being paid. This creates a natural disconnect between pay and performance, as companies and executives sought to position themselves in the market, with no one wishing to be seen as hiring a below average executive.

9. SUMMARY

The remuneration of company executives (CEO's) is an issue that has attracted considerable interest from shareholders, business groups and the wider community. The concerns regarding excessive remuneration packages of CEO's has come on top of longstanding community discomfort about the widening gap between the remuneration of executives and other employees, as well as some large termination payments with perceived lack of justification. Public opinion polling over the years consistently shows that most respondents believe CEO remuneration to be out of control.

9.1. THE STUDY

The main purpose of this study was therefore to determine if CEO's in South Africa are indeed well rewarded, to the detriment of other employees, and if their remuneration can be justified in comparison with their performance. To achieve this, the specific goals of the research was:

- To give account of the current situation in 2009 regarding CEO remuneration and to compare it with a similar study done by the trade union, Solidarity, in 2006;
- To make comparisons between CEO remuneration and the salaries of other employees;
- To determine correlations between CEO remuneration and fundamental business factors;
- To discuss other factors that could be influential determinants of CEO remuneration.

CEO remuneration of 326 companies, as reflected in their annual reports, were analysed by means of certain statistical formulae for the financial years ending between July 2008 and June 2009. The empirical analysis was substantiated by theoretical information and discussions contained in several documents that were obtained from the Internet.

9.2. THE THEORY

The landscape of executive remuneration has become far more sophisticated than it was a decade ago, and complicated share schemes and bonuses are key to that. Executive reward is multifaceted, typically including fixed short-term remuneration in the form of salary and benefits, fixed long-term remuneration in the form of pension, variable short-term remuneration in the form of annual bonus, and variable long-term remuneration in the form of deferred bonus and long-term incentive awards. There are no hard and fast rules to setting a remuneration package level. Some general principles do however apply:

- The remuneration should be enough to attract the right candidate;
- The remuneration should be able to be sold as fair in the context of other salaries in the organisation;
- The CEO's remuneration shouldn't stress the organisation's finances;

- The CEOĝs remuneration should send the appropriate signal to the person, to the staff, and to other stakeholders.

9.3. THE FINDINGS

The average CEO remuneration of all the companies studied was R4.76 million per annum. The average CEO remuneration of the trimmed group (after omitting the top 10% and bottom 10% values) was R3.66 million per annum. The average basic salary of the CEOĝs was R2.37 million per annum for the untrimmed group and R2.09 million for the trimmed group. The average worker earned R124 457.00 in 2009.

The variable portion of CEO remuneration is positively linked to the performance of the Johannesburg Stock Exchange as the 63% portion of variable CEO remuneration in 2006 coincided with a bullish period of share prices on the JSE. However, in spite of the severe negative economic conditions, CEOĝs were still able to double their normal annual earnings in 2009 with óperformance bonusesô when the JSE lost 42% in value during the deep recession. The variable portion of CEO remuneration dropped to 52% in 2009.

CEO remuneration increased by 11.5% per annum on average from 2006 to 2009 while the yearly earnings of the average worker increased by 15.4% over this period. However, the average basic salary of CEOĝs increased by 19.9% per annum from 2006 to 2009.

The average remuneration of CEOĝs was 39 times more in 2006 than that of the average worker. This ratio decreased to 36 times in 2009. The ratio of the average basic salary of CEOĝs increased from 18 to 20 times over the same period. The decreasing ratio of total remuneration is therefore the result of a decrease in the variable portion (mainly performance bonuses) of the CEOĝs in 2009.

With the exception of executive mayors, public office bearers gained on their ratios with CEOĝs from 2006 to 2009 while the CEOĝs gained on public service workers over the same period. CEOĝs still earns twice as much on average as the president of the country and three times more then the cabinet ministers but they earned ten times more then a director general in 2009 while they earned 106 times more than a cleaner in the public service for the same year. The ratios are 9 times and 98 times respectively for 2006.

78% of the CEOĝs earned more in a month than what the average worker earned in a year. In 2009, it took just about three months on average for a CEO to earn R1 million while it will take the average worker eight years to earn the same amount.

Performance of the individual companies is by no means a determinant of CEO remuneration. Although slightly stronger, there is also no convincing indication that company size is a determinant of CEO remuneration. No single business factor therefore emerged as the main determinant of CEO remuneration. Other, less rational factors probably overwhelm the role that business factors play in CEO remuneration.

Performance-based remuneration, often in the form of share options, was endorsed by researchers throughout the world as a way of addressing the principal/agent problem by aligning the interests of the shareholders and the CEOĝs, who act as agents on behalf of the shareholders. There is a correlation between the size of the remuneration package and the variable portion of the remuneration, although no single business factor, least of all company performance, emerged as a determinant of CEO remuneration. Options are therefore not closely linked to the performance of CEOôs, allowing them to benefit from movements in share prices that were due to market and industry trends beyond their control.

Although remuneration committee members approach their jobs with good intentions, intelligence, and integrity, they are not as diligent as they would be if they were spending their own money. The committee in fact only sees plans that have already been óblessedô by top managers and although individual committee members are generally competent and well motivated, the governance system itself is corrupted and tilted in the direction of management in a way that will almost inevitably lead to excesses in the remuneration levels of CEOôs.

Many remuneration packages are determined on the basis of what others in comparable jobs, regardless of performance, are being paid. This creates a natural disconnect between pay and performance as companies and executives seek to position themselves in the market, with no one wishing to be seen as hiring a below average executive.

9.4. CONCLUSION

According to the King Commission, companies should remunerate directors and executives fairly and responsibly. Therefore, CEO remuneration:

- Should be enough to attract the right candidate;
- Should be able to be sold as fair in the context of other salaries in the organisation;
- Shouldnôt stress the organisationôs finances;
- Should send the appropriate signal to the person, to the staff, and to other stakeholders.

The current situation reflects that CEO remuneration increased by 34.4% from 2006 to 2009 while the total earnings of the average worker increased by 46.2% over the same period. Their basic salary increased by 59.6% and the lesser increase of total remuneration was probably only hampered by the poor performance of the JSE in 2009. The performance portion of remuneration is still above 50% in spite of a severe decline in the JSE all share performance and an economic recession over the studied period, meaning that CEOôs could still double their annual earnings with óperformance bonusesô, even under very restrictive economic outcomes.

The average remuneration of CEOôs was 39 times more in 2006 than that of the average worker. Although this ratio decreased to 36 times in 2009, the basic salary ratio increased from 18 to 20 times. The net result is that 78% of the CEOôs earns more in a month than what the average worker earns in a year. The gap between the remuneration of CEOôs and the average workers is not already huge, it is also continuously on the increase, given normal economic circumstances.

There is a correlation between the size of the remuneration package and the variable portion of the remuneration, although no single business factor, least of all company performance, emerged as a determinant of CEO remuneration. The rewarding portion of CEO remuneration is more closely linked to the performance of equity markets than the performance of the company they are managing. In the end, it seems that the small number of CEOÕs are using the conditions of incomplete and asymmetric information surrounding their capabilities to such an extend that, when it comes to remuneration negotiations, their individual bargaining power is far greater than the collective bargaining power of the remaining 8.4 million workers.

The conclusion is that the current levels of CEO remuneration in South Africa is sending out the wrong message regarding fairness to the average worker as it is by no convincing means the result of exceptionally talented performances. Companies will however keep on rewarding their CEOÕs with ever-increasing remuneration packages to convince themselves that their CEO is above average as no organisation wants to admit to having a CEO who is below average. Therefore no company will allow its CEO remuneration package to lag behind market trends and by doing so they keep on giving more momentum to an already dangerously spinning remuneration spiral. The result is that CEO remuneration is in all likelihood indeed out of control.

SOURCES OF INFORMATION

Australia. Inquiry report. No. 49, 19 December 2009. *Executive Remuneration in Australia.* Australian Government Productivity Commission.

Bebchuk, LA & Fried, JM. 2003. *Executive Compensation as an Agency Problem.* Journal of Economic Perspectives, V. 17, No. 3.

Brown, B. 30th September 2009. *Curbing CEO Salaries.* The Greens.
http://bob-brown.greensmps.org.au

Bullock, G. *How to evaluate stocks using ratios*. http://money.ninemsn.com.au/article.aspx

Bussin, M. 2008. *Factors Driving & Influencing Remuneration Policy.* Workinfo.com.
http://www.workinfo.com/free/Downloads/260.htm

Econostats. http://www.econstats.com/eqty/eqem_mi_0.htm

Financial Mail. 2 August 2008 *Executive pay - Is intervention required?*
http://www.leader.co.za/article.aspx?s=1&f=1&a=825

Fin24.com. 11 March 2010. *BMF slams AngloPlat CEO's pay.*
http://www.fin24.com/articles/default/display_article.aspx?ArticleId=1518-1786_2575597

Government Gazette. April 2008. The independent commission for the remuneration of public office bearers. Second report and recommendations.

Heskett, J. 1 June 2007. *How Should Pay Be Linked to Performance?* Harvard Business School Working Knowledge.

Institute of Directors in Southern Africa. 2009. *King Code of governance for South Africa.*

Isles, N. January 2006. *The Risk Myth: CEOs and Labour Market Risk.* Provocation Series Volume 2 Number 4. The Work Foundation.

Jensen, MC, Murphy, KJ & Wruck, EG. July 2004. *Remuneration: Where we've been, how we got to here, what are the problems, and how to fix them.* Harvard Business School NOM Research Paper No. 04-28.

Johannesburg Stock Exchange. http://www.jse.co.za

ourcommunity.com.au. Undated. *CEO Remuneration*
http://www.ourcommunity.com.au/boards/boards_article.jsp?articleId=3492

Paton, N. 19 March 2009. *CEO pay and the Lake Wobegon effect.*
http://www.management-issues.com

PriceWaterhouseCoopers. 2010. *Executive Remuneration in need of a major makeover.*
http://www.pwc.com/za/en/press-room/

Statistics South Africa: Statistical release, P0277. *Quarterly employment statistics.* March 2006, September 2008, September 2007, September 2009, September 2006.

Statistics South Africa: Statistical release, P0441. *Gross Domestic Product*. Fourth quarter: 2009

Schaefer, S. and Hayes, R.M. 2007. *CEO Pay and the Lake Wobegon Effect.* Working paper, University of Utah, Salt Lake City, United States.

Scholtz, HE. 2009. *Share options as part of executive remuneration: aligning the interests of stakeholders.* Southern African Business Review Volume 13 Number 2.

Solidarity Research Institute. July 2006. *Remuneration of Chief Executive Officers: An overview of JSE listed companies.*

South Africa. Act No.71, 2008: Companies Act, 2008

Sutton, B. 4 February 2009. *CEO Compensation Research: Why You Want Rich People to Set Your Pay.* http://bobsutton.typepad.com

The Seatle Times. 5 February 2009. *Goal of Obama's CEO pay cap: Make Wall St. accountable.* http://seattletimes.nwsource.com/html/politics/2008709424_pay05.html

Vermeulen, F. 11 November 2008. *Too hot to handle: Explaining excessive top management remuneration.* RANDOM RANTINGS.
http://freekvermeulen.blogspot.com/2008/10/too-hot-to-handle-explaining-excessive.html

Wikipedia. Undated. *Principal-agent problem.* From Wikipedia, the free encyclopedia.
http://en.wikipedia.org/wiki/Principal-agent_problem

Woodburn, T. 2008. *Executive Remuneration must be Linked to Performance*
http://www.woodburn.co.za/Publications/ExecutiveRemunerationandPerformance/tabid/15536/Default.aspx