Diligent Institute

# More About Pay than About Performance

## Trends to Watch for during the 2021 ASX Proxy Season

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# Executive Summary

In this paper, we analyse changes to chief executive officer (CEO) pay considering the COVID-19 pandemic, as well as trends in remuneration components and performance measures.

Executive remuneration is a vital issue for stakeholders and investors, specifically regarding pandemic-era pay cuts and the inclusion of environmental, social and governance (ESG) performance metrics.

Data and insights from CGLytics (a Diligent brand), provide a current executive pay landscape for both the ASX 300 and the ASX 100. This report gives stakeholders insights into the relative positioning and alignment of CEO total realised pay (TRP) against the total shareholder return (TSR) over one- and three-year periods.

This report also provides essential information on the executive remuneration practices of Australian companies and sheds light on stakeholder concerns to better understand corporate governance trends in the Australian market for the upcoming 2021 proxy season.

## Key Takeaways

- Across all 47 companies that initiated COVID-19 pay cuts, the average CEO TRP **increased by 11%.**
- **Average CEO TRP** of ASX 300-listed companies **decreased by 10.5%** from FY2019 to FY2020.
- **Long-term incentive (LTI) components rose by 14%** from FY2018 to FY2020, while base salary and **short-term incentive (STI) components dropped by 3% and 17%**, respectively.
- **The combined TRP** of the top five highest-paid CEOs is **AUD 266 million**, a 54% increase from FY2019.
- **32 ASX 300-listed companies received strikes** against their remuneration reports in FY2020 compared to 24 companies in FY2019.
- The **consumer discretionary sector had six strikes** against their remuneration reports in FY2020, the highest among all sectors.
- **99 ASX 300 companies had an aligned relative positioning of remuneration and performance** over three years, while 103 companies have overpaid their CEOs and 80 companies have paid their CEOs conservatively.
- The number of **ASX 300-listed and ASX 100-listed companies that introduced ESG performance** metrics has **increased to 20% and 21%**, respectively, in the last year.

# Background

The COVID-19 pandemic has brought about drastic changes for the Australian workforce. These changes have created a balancing act between employers, who want to keep their businesses operational, and employees, who want to retain their jobs and ensure their own safety.

The Australian government tried to stabilise the pandemic-stricken economy by providing employers and employees with an AUD 90 billion JobKeeper subsidy scheme. Many companies considering redundancies and pay cuts opted into the JobKeeper subsidy to survive. However, as the funds were allocated, issues arose over how the subsidy was given out and used by companies.

The subsidy's eligibility criteria required companies to demonstrate a 30%–50% projected decline in sales, with little regard as to how those projections were calculated[i]. Our data suggests that the six largest JobKeeper recipients in the ASX paid their CEOs a combined sum of AUD 10.5 million in the form of fixed pay and STIs. Their combined TSR was also down by (120.50%) from 98.4% in 2019. Some ASX 300 companies paid dividends to their shareholders while receiving JobKeeper payments.

These practices were seen across many industries and sectors including finance, healthcare, communications, mining, professional services and retail. Yet, the Australian Tax Office (ATO) has not made a conclusive statement on this potential misuse of JobKeeper funds, stating that analysis into how companies utilised funding was beyond the ATO's scope[ii].

According to the ATO, the largest economic subsidy scheme in Australia's history signed up more than 3.6 million people during the peak of the pandemic before decreasing to 1.54 million in the later months of 2020[iii]. Despite the subsidies, Australia has yet to make a full recovery. The end of JobKeeper, leading to the unemployment and underemployment of over 600,000 people[iv]; industries that rely on large gatherings and travel still struggling to recover; and the potential misuse of JobKeeper funding have all contributed to a slow and irregular recovery for the Australian economy.

# Projected 2020 vs Actual 2020

## CEO Pay Cut Recap

In CGLytics' 2019 proxy season report, "***Avoiding a First Strike During a Pandemic***," we reported that 60 of the ASX 300 companies announced CEO pay cuts from March 2020 until August 2020. Fifty-four of those companies disclosed the proposed percentage cuts.

Of those 54 companies, 65% promised to cut CEO base salary, 31% committed to a cut in both CEO base salary and STIs, and 4% proposed cuts only to STIs.

CGLytics calculated these companies' projected 2020 CEO TRP based on the pay cuts announced and using their 2019 realised compensation. When comparing projected and actual 2020 CEO pay, it is important to note that we have removed seven companies that have since dropped off the ASX 300, bringing the sample size to a total of 47 companies.

## Did the Announced CEO Pay Cuts Happen?

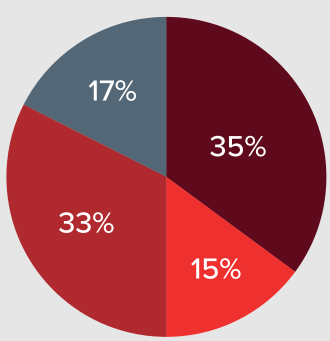
Comparison analysis of the projected and actual CEO TRP has shown that 24 companies decreased their TRP, while 23 companies have increased their TRP despite promising CEO pay cuts.

Across all 47 companies, the average TRP percentage change was an increase of 11%.

- **24 companies decreased** CEO total realised pay.
- **23 companies increased** CEO total realised pay.
- The average percentage change in **CEO total realised pay was an increase of 11%**.

Total Realised Pay: Projected 2020 vs. Actual 2020

Source: CGLytics




- Companies with up to 50% decrease
- Companies with up to 50% increase
- Companies with more than 50% decrease
- Companies with more than 50% increase

The chart indicates that 15 companies increased their CEO TRP by up to 50%, while eight companies had increases of over 50%. A majority of the eight companies reported that the increase in CEO TRP was due to a vesting of long-term incentives (LTI). Two companies received strikes of more than 45% voting against their respective 2020 remuneration reports.

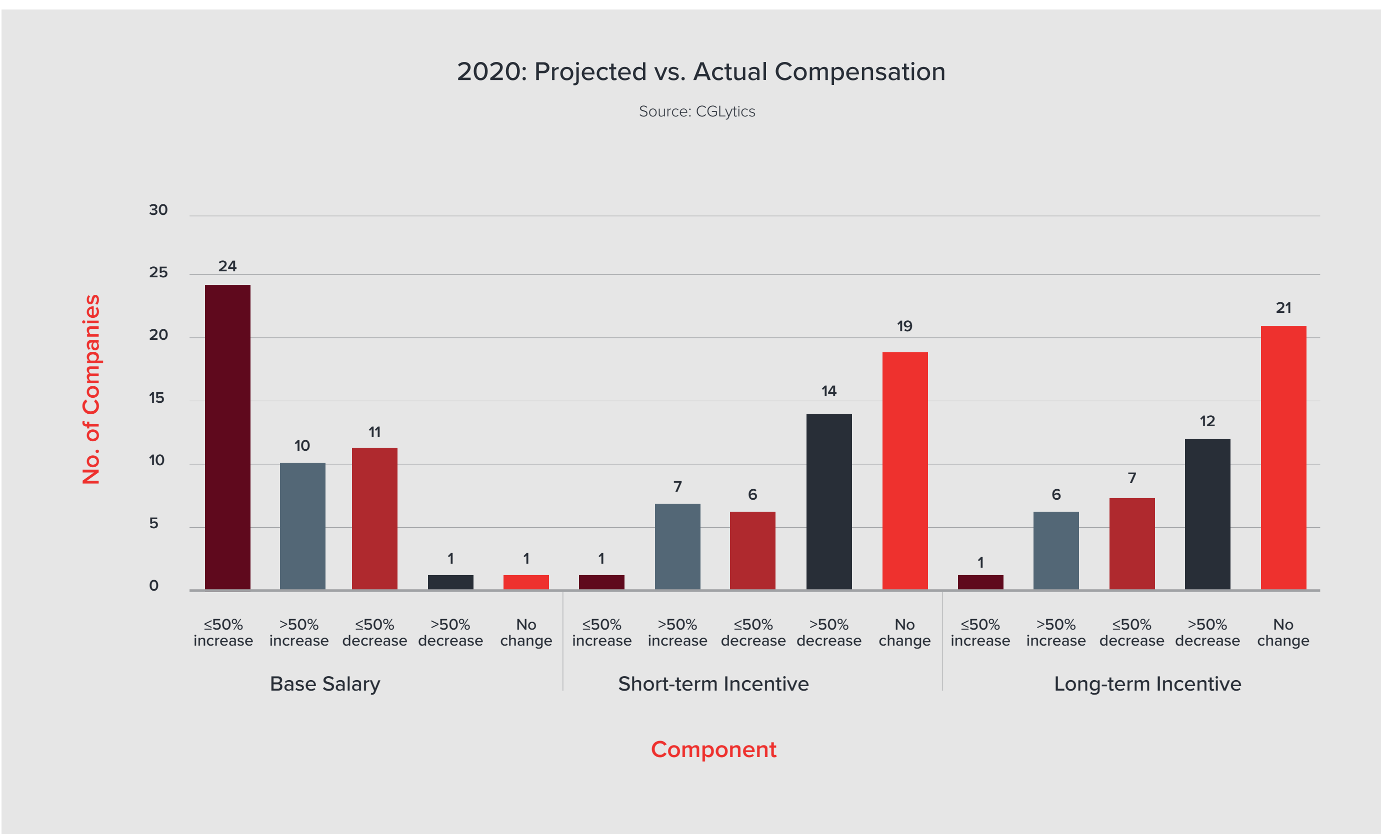
Comparatively, 16 companies decreased their CEO TRP by up to 50%, with another seven companies reducing their CEO TRP by more than 50%. Despite its lower CEO TRP, one of the seven companies nonetheless received a 45% strike against its remuneration report, because it was one of the 25 ASX 300-listed companies that paid out bonuses while also collecting JobKeeper payments[v].

## Which Components Were Affected?

CEO remuneration largely comprises three components: base salary, short-term incentives and long-term incentives. When comparing projected and actual 2020 CEO TRP, the 47 companies that announced pay cuts had a 36% increase in average base salary, a 14% decrease in STIs and a 7% decrease in LTIs.

- **STI components** were the most **negatively affected.**
- **Base salary** components had the **highest growth.**
- **21 companies** had **no change** in LTI growth.

Thirty-four companies increased their CEO base salaries despite 25 of the 34 companies having indicated planning base salary reductions. On the other hand, 12 companies decreased their base salaries. Eight companies increased their STIs while 20 companies decreased them. Lastly, seven companies increased their LTIs while 12 companies decreased the LTI component of the TRP. The STI component was the most negatively affected, demonstrating that many companies decided to withhold the payment of annual bonuses over cutting base salaries and deferring the vesting of LTI plans.



- **The healthcare sector** had the **biggest** average **base salary increase.**
- **The industrials sector** had the **largest** average **STI increase.**
- **The communications sector** had the **largest** average **LTI increase.**

The consumer staples sector had the largest overall TRP cuts, with an average decrease of 20% across all three components. One company in the consumer staples sector forwent 30% of its CEO salary and received no cash for STIs in 2020[vi].

The energy sector saw the highest overall increase, with an average 30% surge across all components. One energy company received an over 50% strike against its 2020 remuneration report despite its promised pay cuts. The company was reported to have allocated 67.5% of all STIs to its CEO and executives, with 37% given in cash and 63% deferred as equity. This was all done while more than 400 workers were made redundant during the pandemic[vii][viii]. This may be an indication that this company was overpaying its executives while struggling to pay for employee wages[ix].

# Actual 2019 vs Actual 2020

## CEO Pay Cut Recap

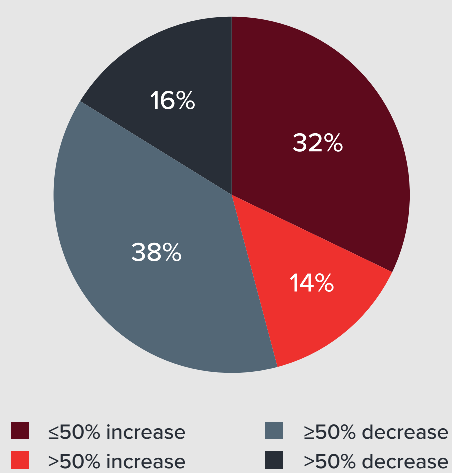
Below, we compare the actual 2019 and 2020 CEO TRP for the whole of the ASX 300, regardless of whether they initiated CEO pay cuts. We have only included 281 companies in our ASX300 analysis, as 19 companies did not provide CEO remuneration data from either 2019 or 2020.

- There was a **10.5% decrease** in the **average CEO TRP** from 2019 to 2020.
- **54%** of ASX 300 companies **lowered their CEO TRP** in 2020.
- **STI was the most negatively impacted** component for the ASX 300 in 2020.

One hundred and fifty-two companies (54% of the ASX 300) decreased CEO TRP while one hundred and twenty-nine (46% of the ASX 300) increased it. The large-scale decrease in CEO TRP is in part certainly due to the pandemic, as 2018 and 2019 data indicates that 84% of ASX 300 companies displayed trends of increasing CEO TRP.

Actual 2019 vs. Actual 2020:
ASX 300 CEO Total Realised Pay

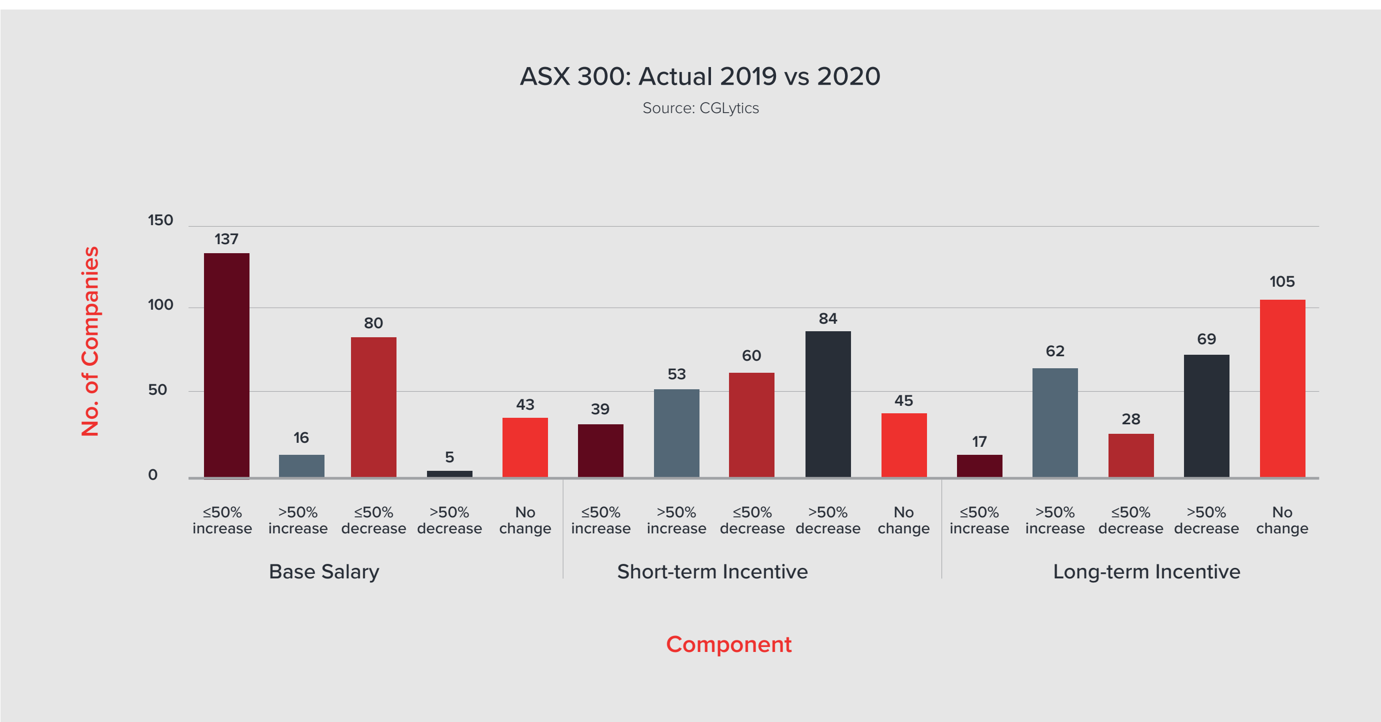
Source: CGLytics

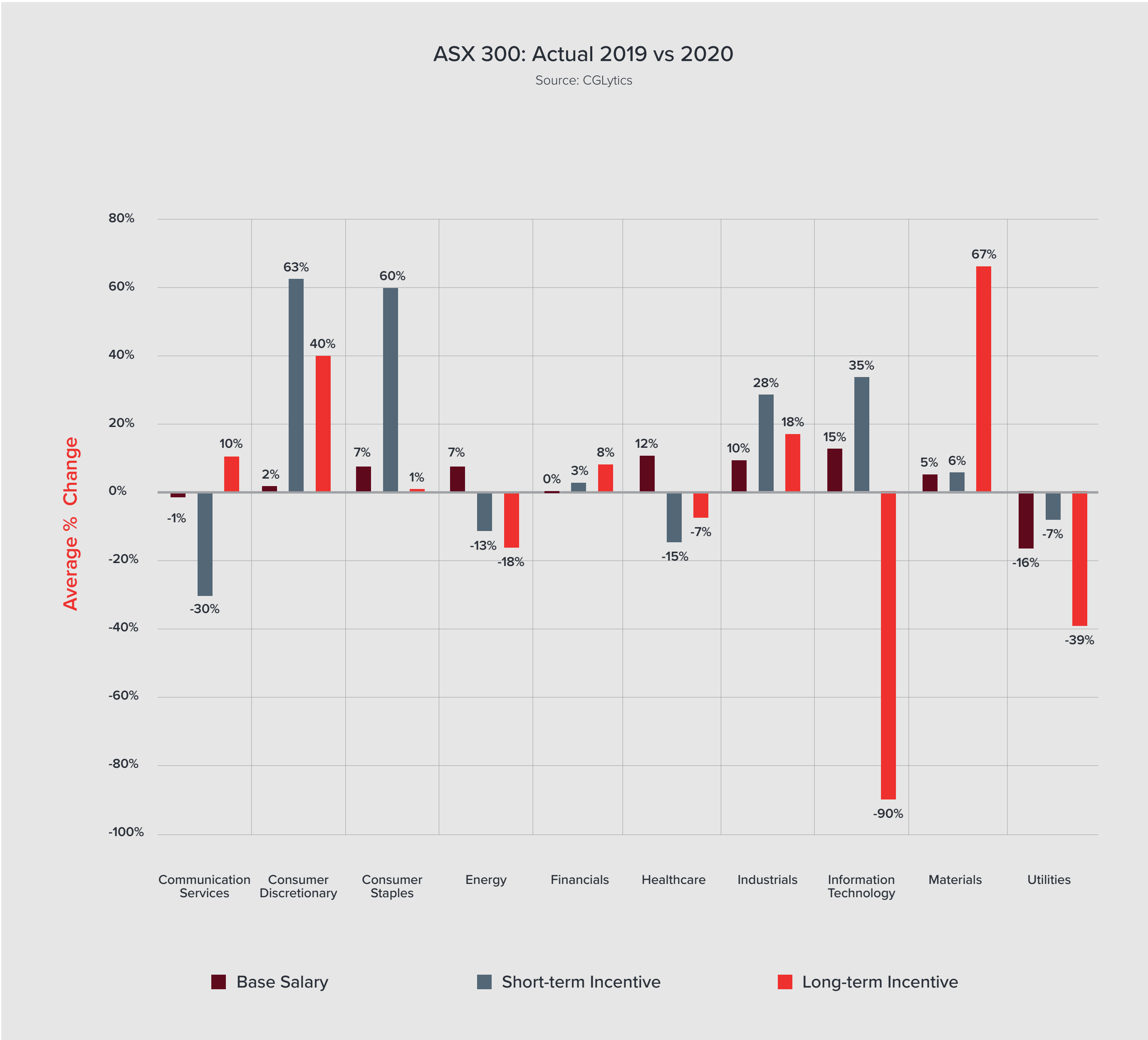


## Which Components Were Affected?

- **54%** of ASX 300 companies **increased their CEO base salary** in 2020.
- **51%** of ASX 300 companies **decreased their CEO STIs** in 2020.
- **28%** of ASX 300 companies **increased their CEO LTIs** in 2020.

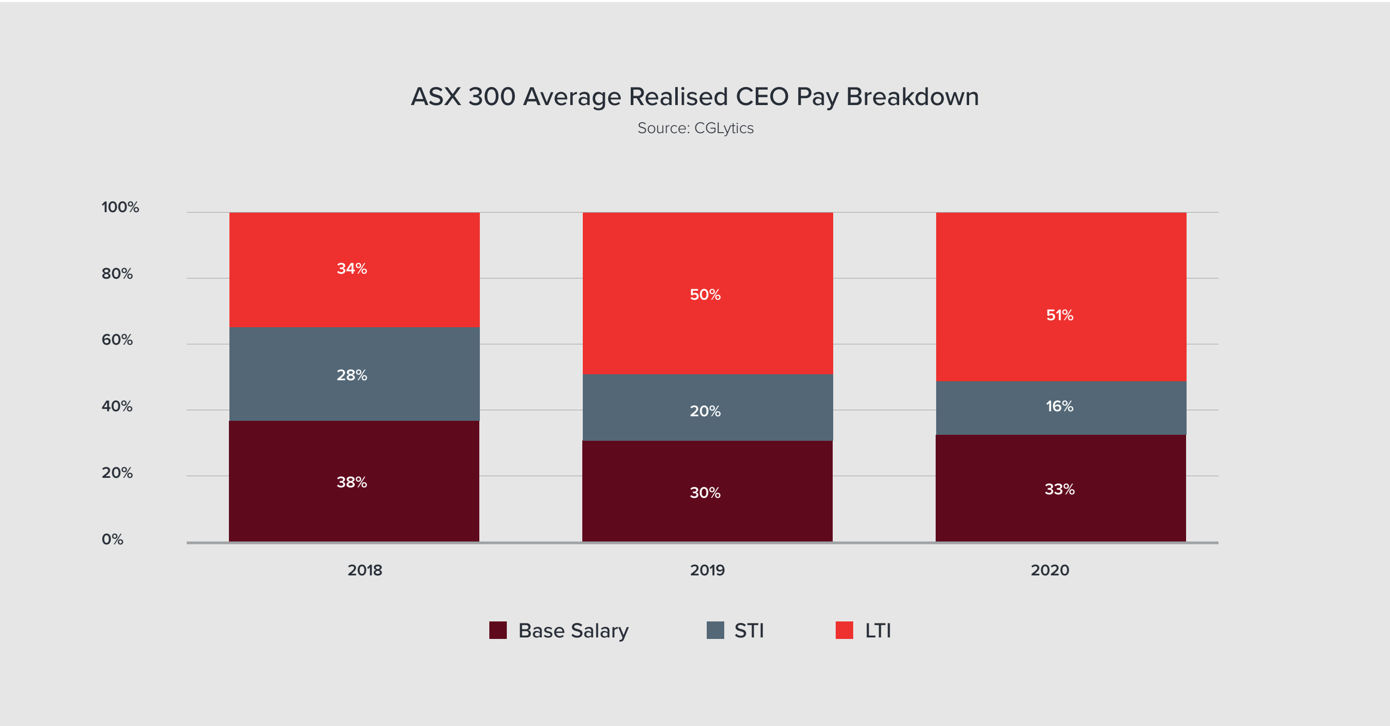
This chart indicates that STIs are the most negatively affected remuneration component among ASX 300 companies. The decrease in STIs may be the result of companies wanting to preserve cash during the pandemic but may also be due to a pre-pandemic trend of companies emphasizing long-term value creation (and a higher proportion of LTIs in CEO remuneration)[x]. Another reason for a sharp decline in STIs may be due to STIs being a smaller and less valuable portion of CEO remuneration[xi].






- The **information technology** sector saw the **largest increase in base salary.**
- The **consumer discretionary** sector saw the **largest increase in STIs.**
- The **materials** sector saw the **largest increase in LTIs.**

## CEO Pay Breakdown 2018–2020




The chart above indicates that the LTI component of executive remuneration has been increasing over the past several years. LTIs have been the only growing component in CEO TRPs, with data from 2018 to 2020 conveying 14% growth in LTIs with a 17% and 3% decline in STIs and base salaries, respectively. The LTI to STI ratio was 1.21 in 2018 but increased to 3.18 in 2020.

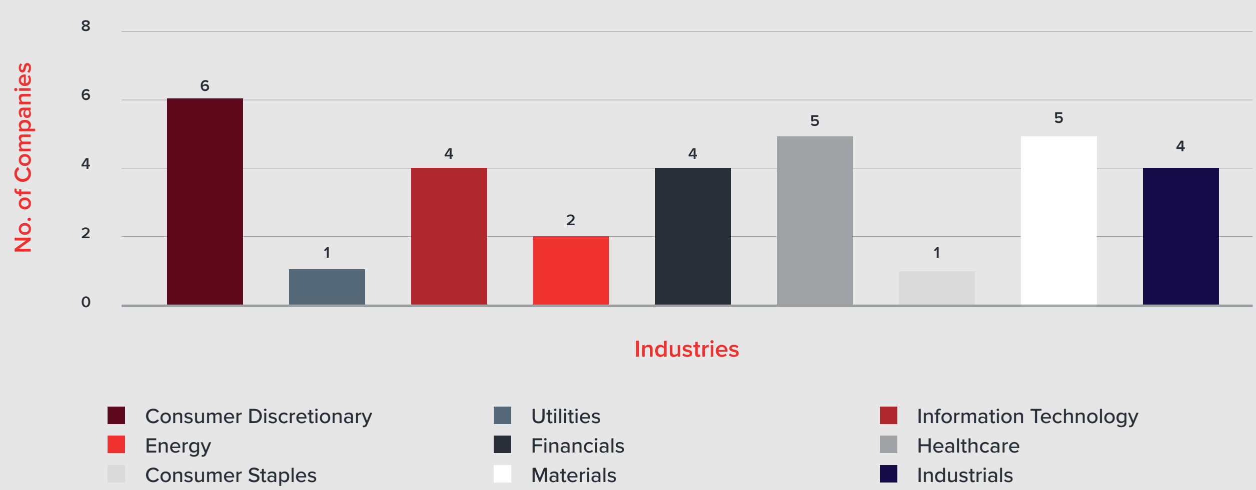
# AGM Strikes on the Rise

Investors expected a more conservative approach to executive compensation in 2020, and that expectation will drive through the 2021 proxy season as well, especially with the pandemic's effect on businesses and employees. Despite companies' promises to take pay cuts and reductions, some investors were dissatisfied with remuneration reports detailing the outcomes.

Thirty-two ASX 300-listed companies received strikes against their remuneration reports in 2020 compared to 24 companies in 2019. Nineteen of the 32 companies received up to 50% 'no' votes on their remuneration reports, with 13 companies facing more than 50% 'no' votes on their reports in 2020.

AGM Strikes

Source: CGLytics




The consumer discretionary sector had the greatest number of strikes against remuneration reports in 2020, followed by the healthcare and materials sectors. According to Glass Lewis, a significant cause for these strikes may be the CEO bonuses given out by some companies despite their drop in earnings. One company from the consumer discretionary sector was found to have been collecting JobKeeper payments when they paid out 100% of their CEO cash bonus in 2020. Another company disclosed that they will be giving only 53% of the maximum CEO cash bonus but has noticeably increased its STIs from 2019[xii].

While 26 of the 32 companies experienced one strike, six companies experienced a second strike. One company in the materials sector experienced three strikes in three consecutive years per a report by Glass Lewis. While holding this year's AGM, this company received 93% 'no' votes against its remuneration report, with investors showing concern over the uncapped, short-term incentives offered to the company's CEO.

# Pay for Performance

The CGLytics Pay for Performance software tool shows the relative positioning of both the ASX 300 and ASX 100 companies from 2018 to 2020 and compares the CEO's three-year TRP against the company's three-year total shareholder return (TSR). We have only included 281 companies in our ASX 300 analysis, as 19 companies did not provide CEO remuneration data from either 2019 or 2020, and 98 companies in our ASX100 analysis, as two companies did not have a three-year TSR.

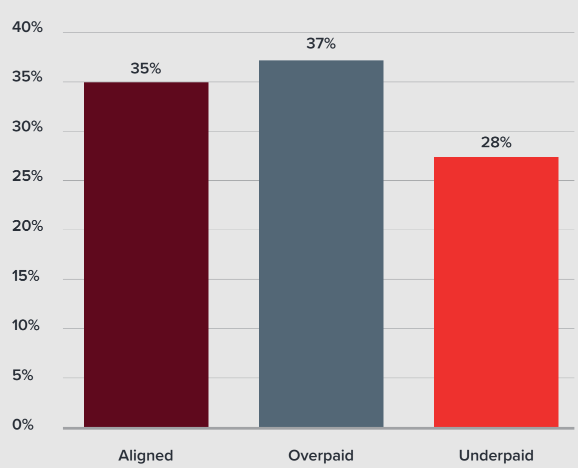
## ASX 300

- **99 companies (35%) have an aligned** relative positioning over three years, as the change in relative TRP and TSR is similar.
- **103 companies (37%) have overpaid their CEOs**, as CEO TRP is relatively higher than their company TSR compared to the market.
- **80 companies (28%) have underpaid their CEOs**, as CEO TRP is relatively lower than their company TSR compared to the market.

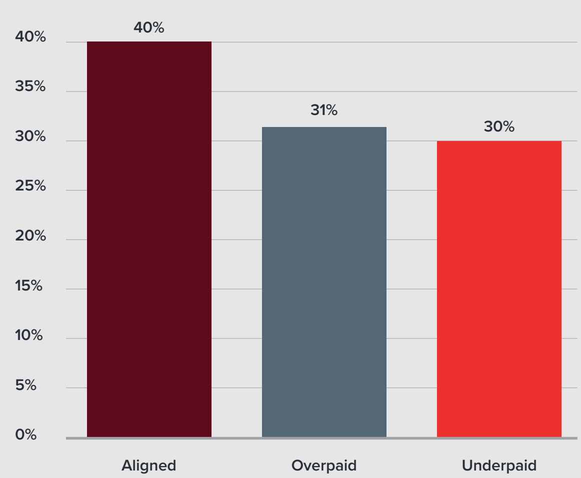
## ASX 100

- **39 companies (40%) have an aligned** relative positioning over three years.
- **30 companies (31%) overpaid their CEOs,** as CEO total realised pay is relatively higher than their company TSR.
- **29 companies (30%) underpaid their CEOs,** as CEO total realised pay is relatively lower than their company TSR.

ASX 300: Pay for Performance Alignment (2018-2020)
Source: CGLytics




ASX 100: Pay for Performance Alignment (2018-2020)
Source: CGLytics



# CEO Pay for Performance Alignment After COVID-19 Pay Cuts

CGLytics compared the projected and actual CEO pay (TRP) and company performance (TSR) alignments of the ASX 300 and ASX 100 companies for the year 2020. The projected 2020 figures used in this analysis are based on 2019 data and take into consideration the promised pay cuts resulting from the pandemic.

The analysis indicates that the expected COVID-19 pay cuts made by the companies did not contribute to aligning companies' CEO pay and company performance. Furthermore, the data shows that the ASX 300 has a higher proportion of companies that overpaid their CEOs when compared to the ASX 100.

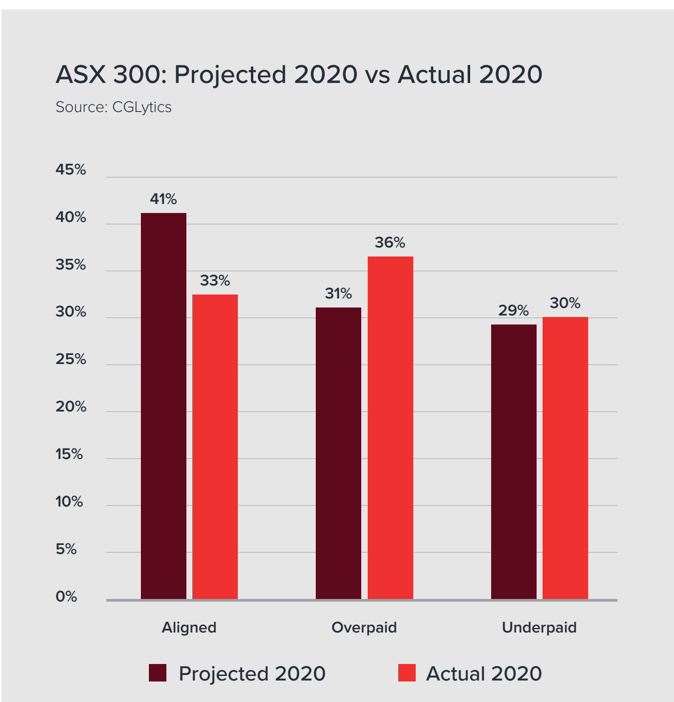
## ASX 300

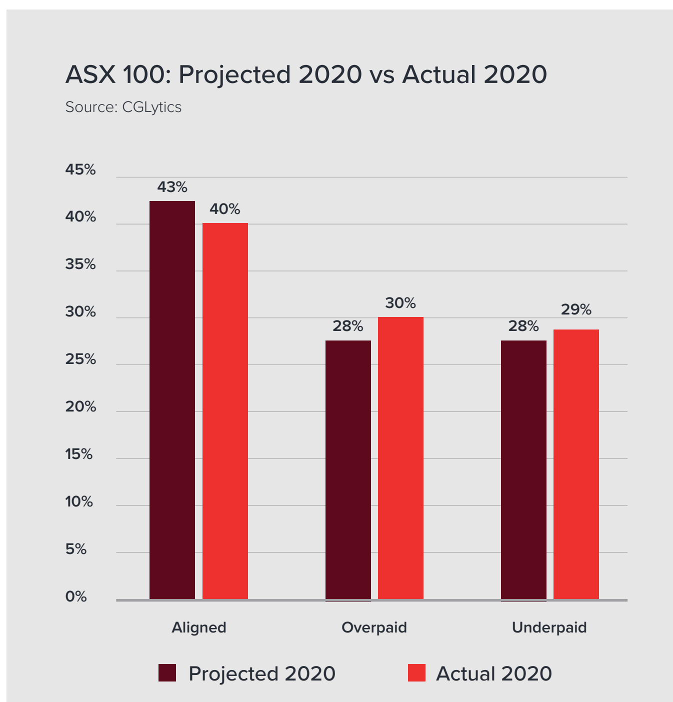
- There was a **19% decrease** in aligned companies.
- There was a **16% increase i**n companies that overpaid their CEOs.
- There was a **3% increase** in companies that underpaid their CEOs.

## ASX 100

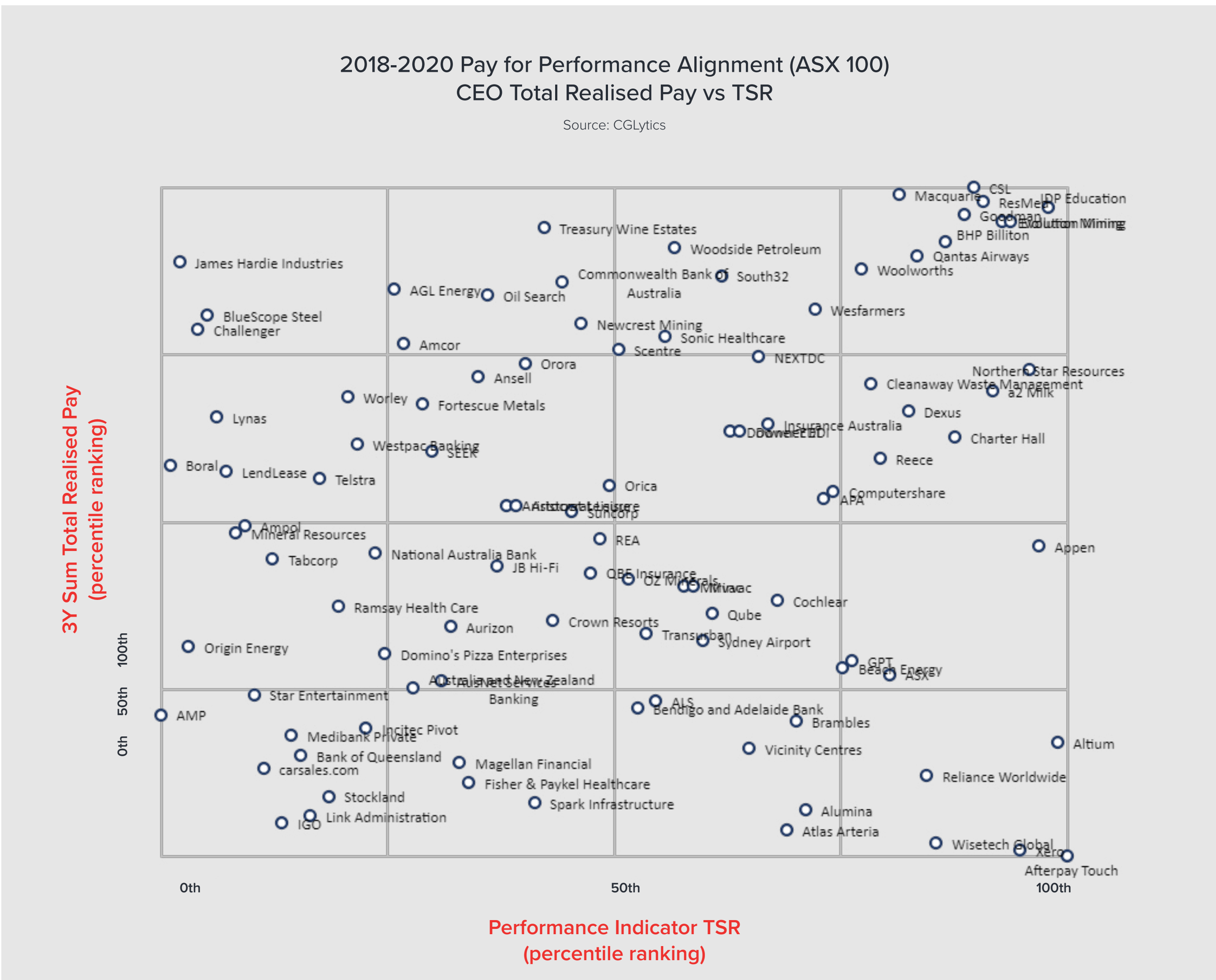
CGLytics created the same CEO pay for performance analysis for ASX 100 companies using the same data.

- There was a **6% decrease** in aligned companies.
- There was a **7% increase** in companies that overpaid their CEOs
- There was a **3% increase** in companies that underpaid their CEOs.



# CEO Three-Year Pay for Performance Positioning (ASX 100)



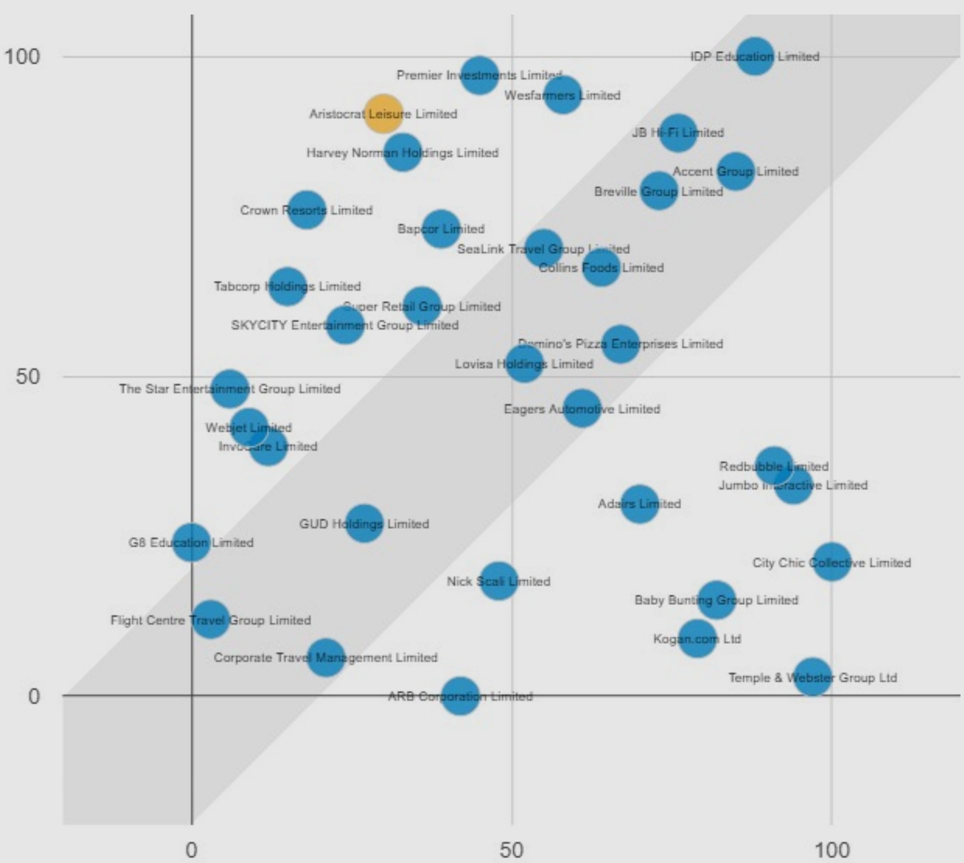
The retail and consumer goods companies are represented under the consumer discretionary sector and represent one of the most severely impacted sectors in Australia. Subsequently, ASX 300 companies in the consumer discretionary sector show a high degree of misalignment.

- **12 companies are aligned.**
- **13 companies overpaid** their CEOs.
- **Nine companies underpaid** their CEOs.

Among the six consumer discretionary companies that received strikes, four of them overpaid their CEOs. This indicates that a company's executive compensation alignment may influence shareholder voting.

CEO One-Year Pay for Performance Positioning (Consumer Discretionary Industry)

Source: CGLytics




CEO Total Realised Pay (percentile ranking)

3Y Total Shareholder Return (percentile ranking)

# Governance Trends Going into 2021 Proxy Season

## AGMS

The two-strike rule introduced to Australia in 2011 has fostered greater company accountability regarding executive pay. With shareholders thus having more voting power over executive remuneration, they have sought professional services from proxy advisory firms to provide non-binding recommendations.

Although the two-strike rule balanced the status quo between investors and companies, a new proposed proxy rule by the Australian Federal Treasury (AFT) could significantly impact the existing two-strike rule[xiii]. According to the proposal, proxy advisory firms would be required to make their advice available to companies five days before it is available to their clients.

Furthermore, Australia's major advisory firms would have to demonstrate that they are 'meaningfully independent' from superannuation funds to promote greater transparency[xiv].

This new proposal is still in its early stages and has not had any assumed impact on corporate governance. The new rule intends to promote greater transparency between investors and the board and may help companies prepare for and mitigate the risk of second strikes.

This proposed rule has provoked reluctance from some advisory firms[xv]. Glass Lewis stated that there was little evidence to suggest the existence of such serious problems as to garner the proposal of a new rule[xvi]. Furthermore, the Australian Securities and Investments Commission (ASIC) conducted a multi-year consultation and field study that concluded issues regarding advisory firm influence over investors are largely overstated[xvii].

Holding online/virtual AGMs was not permitted under the Corporations Act. However, this has changed in current circumstances due to restrictions on travelling and social distancing. Based on guidance published by ASIC, most companies held their AGMs in a hybrid form, where both physical presence and virtual facilities are enabled. This has subsequently resulted in many companies altering their constitution to accommodate this new method of holding AGMs.

## Climate Change

A significant trend over the past several years is investor focus on environmental, social and governance (ESG) issues, particularly climate change and the promotion of diversity in corporate leadership. With widespread awareness of climate change and multinational climate agreements such as the Paris Agreement, companies and investors have placed a considerable emphasis on becoming carbon-neutral[xviii].

This environmental issue was brought up as one of the voting items for an energy company in their 2020 AGM. More than 50% of shareholders voted for a climate change resolution[xix]. This is a prime example of how committed investors can be to ensure company operations transition to less carbon-intensive means and ultimately aim to be carbon neutral[xx] . While it remains uncertain what impact regulators will have regarding environmental issues, investors and their expectations are enough to push businesses in a more environmentally friendly direction.

Beyond the previously mentioned strategies, there have been various multinational initiatives to hold companies accountable for their environmental impact. Global Reporting Initiative (GRI), which is used by over 2,000 organisations worldwide, and the Task Force on Nature-Related Financial Disclosures (TNFD) are two examples of such initiatives aimed at supporting investors to finance environmentally friendly companies[xxi]. While these initiatives are in the early stages, they may have considerable influence over corporate governance in the future.

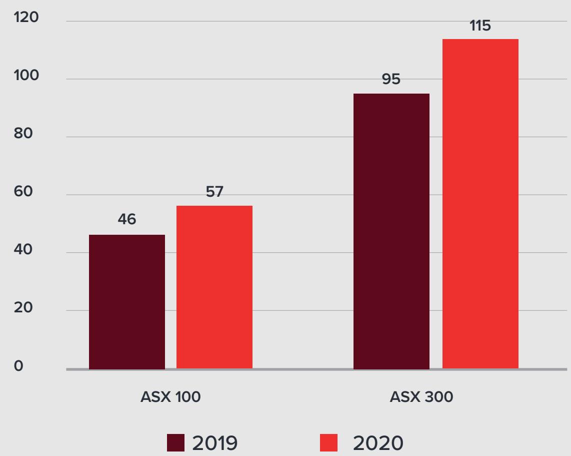
# ESG Performance Measures

A method used by companies to demonstrate their commitment to ESG issues is to incorporate them into executive key performance indicators (KPIs).

Our analysis demonstrates how companies have implemented ESG metrics into executive KPIs in 2019 and in 2020. The number of companies that have introduced ESG performance metrics has increased over the last year, with a 21% increase for ASX 100 companies and a 20% increase for ASX 300 companies. Across ASX 300 companies, 114 companies have applied ESG metrics, resulting in a total of 38% of the ASX 300 now employing ESG metrics.

No. of Companies with ESG-related KPIs by Index

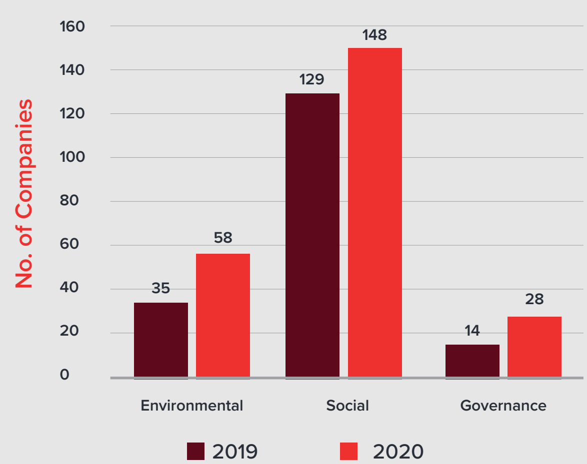
Source: CGLytics




Although climate change is considered the principal subject matter within the ESG sphere, the largest classification goes to the social element of ESG. These classifications include policies surrounding such issues as health and safety, diversity and inclusion, and workplace culture.

Distribution of ESG-related KPIs

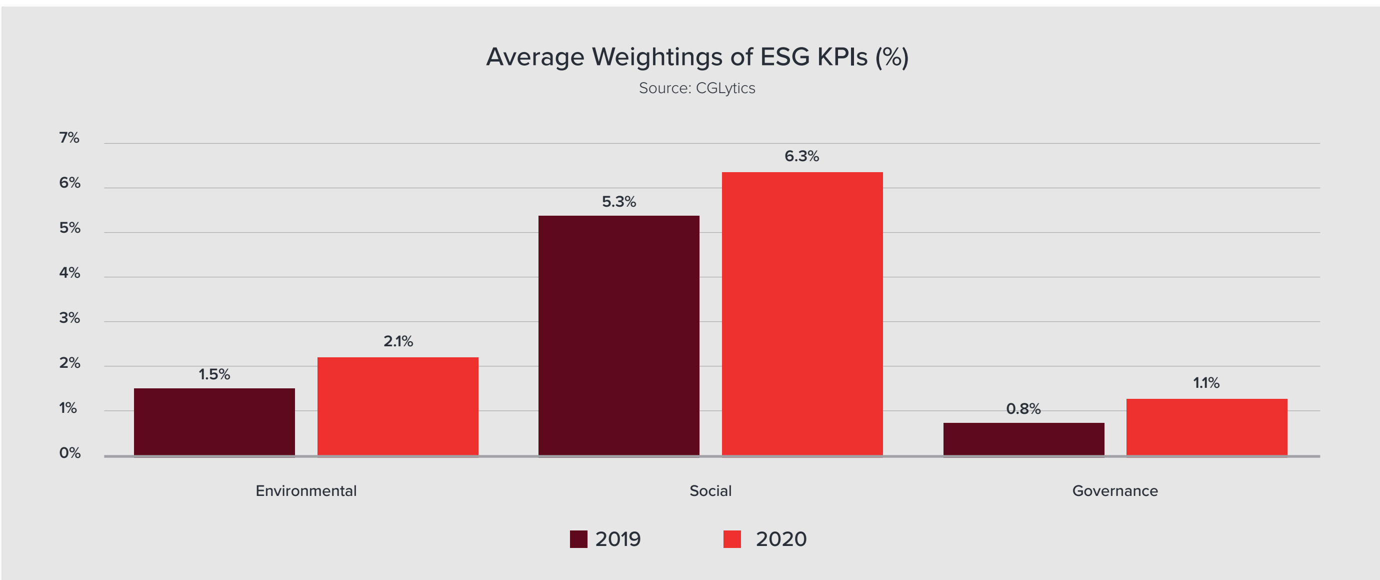
Source: CGLytics



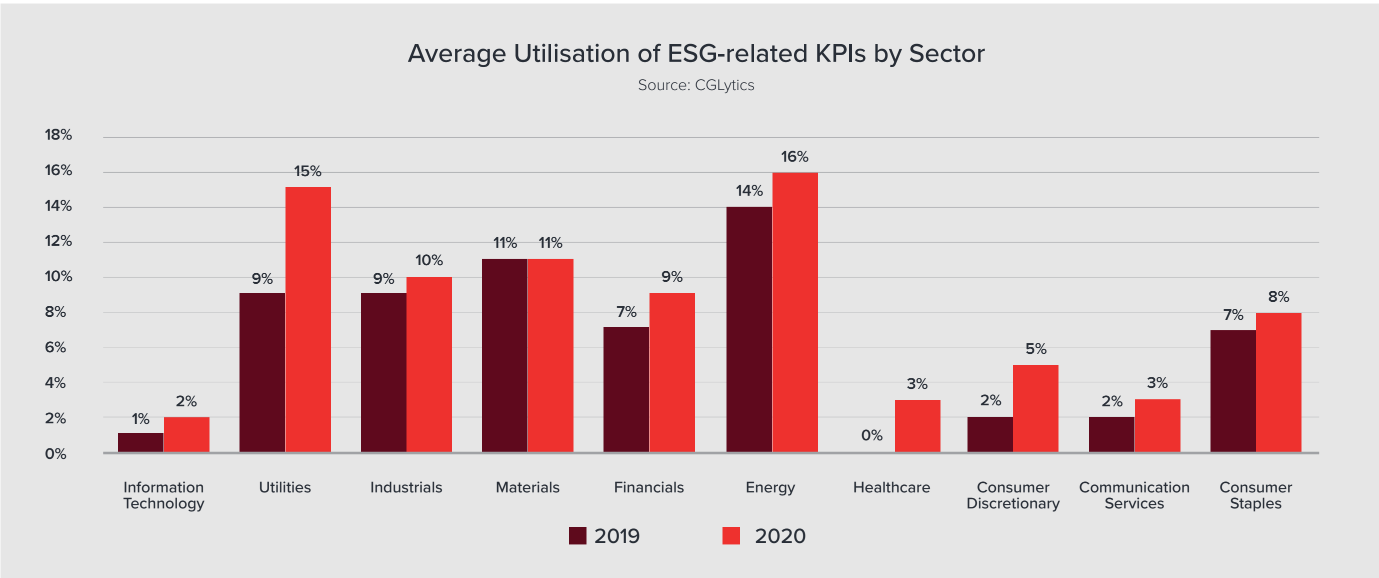
As the number of companies that have introduced ESG metrics is increasing, the weighting given to these metrics also indicates some growth; however, the overall weights still seem moderate.

Aggregating all KPIs and their weights that were applied at ASX 300 companies, the average weight of social indicators stood at 5.3% in 2019 and 6.3% in 2020. Environmental metrics accounted for 1.5% in 2019 and 2.1% in 2020, which indicates 42% growth in the weighting of these indicators in course of one year. Governance metrics reached 1.1% in 2020.

The aggregated weighting of environmental, social and governance factors stood at 9.5% in 2020, which is higher than the weight in 2019 by 1.9 percentage points. This may be an indication that ESG metrics will play a more prominent role within performance indicators.



When comparing the use of ESG metrics in KPIs across industries, the carbon-intensive sectors have introduced a higher usage rate. The energy sector incorporated the greatest number of ESG metrics, followed by the materials and industrials sectors. However, the utilities sector has shown the greatest growth in ESG metric utilisation, from only 9% in 2019 to 15% in 2020. The carbon-intensive industries and sectors arguably place greater importance on ESG metrics given their greater need to reach carbon neutrality targets.




In summary, our data shows that several companies have already included some ESG-related indicators in the executive performance evaluation, and the number of these companies has grown over the past few years. This is in line with the increasing demand from investors for companies to disclose ESG goal setting.

# Resources

[i] https://www.smh.com.au/business/companies/shame-on-companies-that-use-jobkeeper-subsidy-to-pay-executive-bonuses-20210127-p56xab.html

[ii] https://www.abc.net.au/news/2021-02-12/ato-and-jobkeeper/13145990

[iii] https://www.abc.net.au/news/2021-03-29/jobkeeper-ends-what-now-for-australian-businesses/100031668 March 2021

[iv] http://www.roymorgan.com/findings/8722-australian-unemployment-estimates-may-2021-202106040743

[v] https://www.smh.com.au/business/markets/asx-to-fall-scene-set-for-fiery-crown-agm-20201022-p567fq.html

[vi] https://client.cglytics.com/media/documents/6d/a1/6da109962fca6565a3028fa874703814d73c23e3/2020.pdf?v=1600297989

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[viii] https://cdn-api.markitdigital.com/apiman-gateway/ASX/asx-research/1.0/file/2924-02250164-2A1234051?access_token=83ff96335c2d45a094df02a206a39ff4

[ix] https://www.abc.net.au/news/2020-04-17/ceo-pay-cuts-during-coronavirus-should-not-impress-us/12149380

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[xiv] https://treasury.gov.au/sites/default/files/2021-04/c2021-169360_consultation_paper.pdf

[xv] https://www.manifest.co.uk/australian-investors-hit-out-at-planned-proxy-rules/

[xvi] https://www.glasslewis.com/call-for-comment-on-australian-treasurys-counter-productive-proxy-reforms/

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[xix] Freeburn, Lloyd and Ramsay, Ian, An Analysis of ESG Shareholder Resolutions in Australia (October 5, 2020). University of New South Wales Law Journal, Vol. 44, No. 3, 2021, forthcoming, Available at SSRN: https://ssrn.com/abstract=3859264

[xx] https://www.manifest.co.uk/oil-giants-under-pressure-a-turning-point-for-esg-investing/

[xxi] https://www.manifest.co.uk/new-commitments-to-biodiversity-from-government-and-business/

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