

Executive Compensation in New Zealand: the Good, the Bad & the Ugly

Glenn Boyle

*New Zealand Institute for the Study of Competition &
Regulation*

Helen Roberts

University of Otago



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OF COMPETITION AND REGULATION INC.

Background

- Sept 1993: Revised Companies Act mandates compensation disclosure from 1 July 1997
- Previously, commercial surveys only information source: not much use to researchers
- Mandatory disclosure of employee remuneration a controversial move
- For: Minister of Justice, Securities Commissioner, Shareholder Advocates
- Against: Business Roundtable, Employers Federation, Fletcher Challenge, Privacy Commissioner



Reasons Cited for Supporting Disclosure

- Greater transparency
- More effective monitoring by shareholders
- Comparability with government employees
- Align with international practice



Reasons Cited for Opposing Disclosure

- Privacy concerns
- Fewer performance-related compensation packages
- Commercial sensitivity
- Upward pressure on lower end of compensation range
- Compliance and avoidance costs



Economic Theory

- "An economist is someone who sees something working in practice and wants to know if it'll work in theory."
- Executive compensation seen as a reaction to manager-stockholder agency problem
- 'Optimal contracting'
 - *Alleviates* agency problem.
 - Compensation contracts provide incentives to maximise shareholder value
- 'Managerial power'
 - *Exacerbates* agency problem
 - CEOs extract compensation contracts that serve their own interests.



NZ Empirical Evidence

- Andjelkovic, Boyle and McNoe (PBFJ, 2002)
 - CEO pay unrelated to past performance, 1997-98
- Gunasekaragea and Wilkinson (IJBS, 2002)
 - CEO pay unrelated to past performance, 1998-2000
- Elayan, Lau, and Meyer (SEF, 2003)
 - Firm performance unrelated to past CEO pay, 1997-98
- Implication: remuneration structures neither motivate nor discipline NZ CEOs
- But based on small samples



Our Approach

- Use data through 2002
- Identify and describe 1997-2002 trends in:
 - Compensation levels
 - Compensation and contemporaneous performance
 - Governance features relevant to compensation



Sample

- Firms listed on the NZ stock exchange main board for at least one full year in 1997-2002
- Less those firm-years for which necessary data were unavailable.

YEAR	NUMBER OF FIRMS
1997	84
1998	88
1999	74
2000	75
2001	76
2002	79



Data

- Compensation and governance information: annual reports
 - Otago University annual report collection
 - Datex
- CEO: includes salary, bonus, benefits, and shares, but not options or retirement payments
- Chair: Includes director fees, but not consulting fees
- Shareholder return: OU NZ share price database

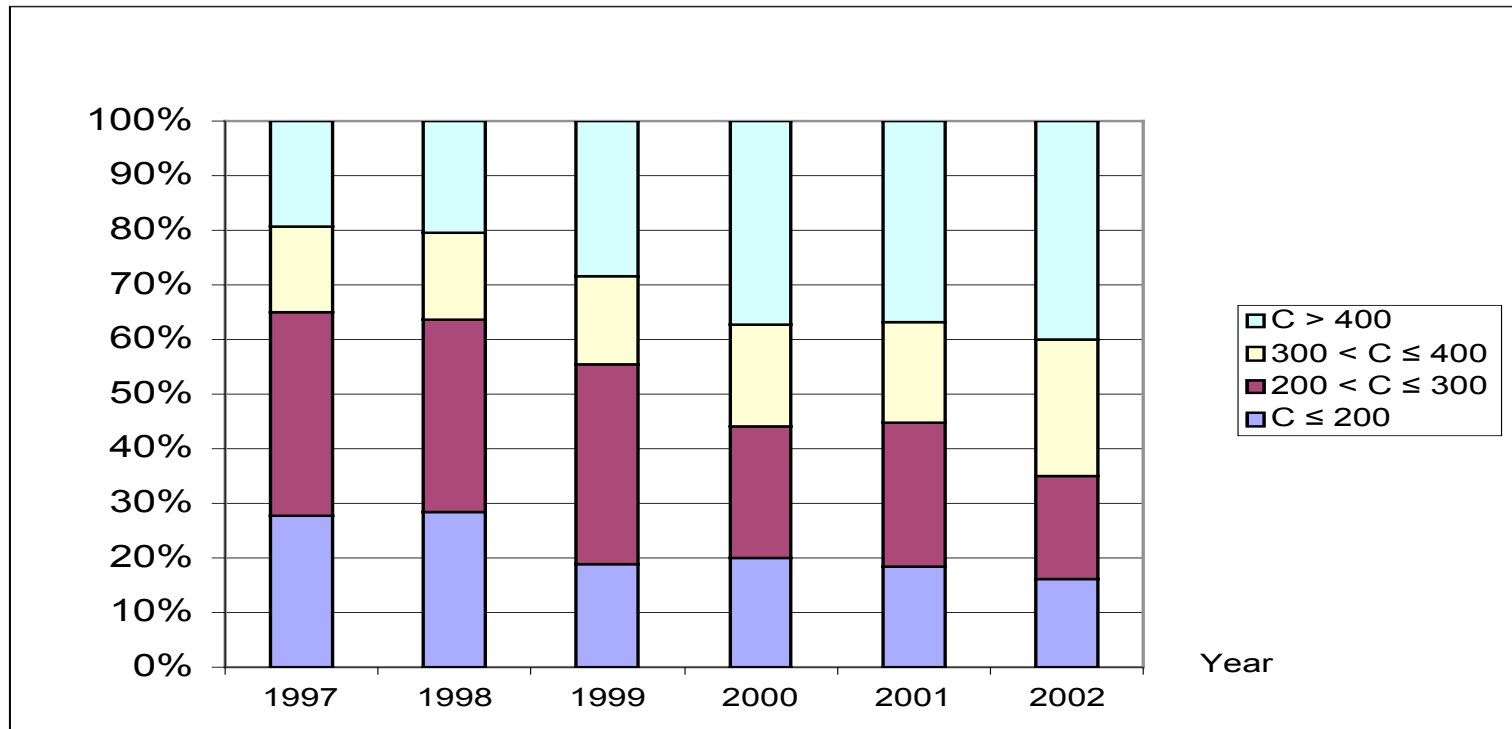


Average CEO Remuneration

Year	Mean (\$000)	Median (\$000)
1997	324	249
1998	342	255
1999	381	282
2000	401	321
2001	410	330
2002	456	355
Annual growth rate	6.8	7.1



Distribution of CEO Remuneration

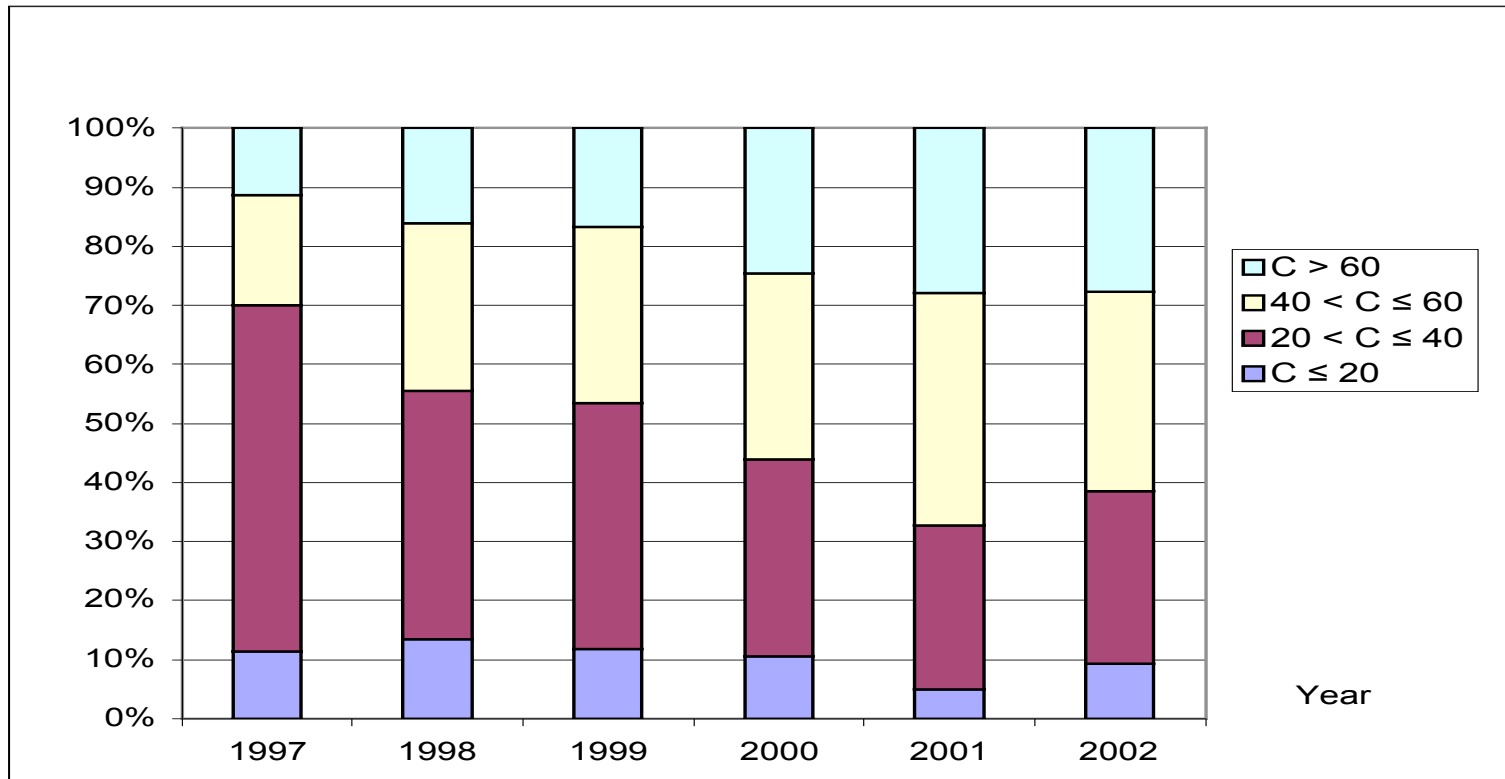


Average Chair Remuneration

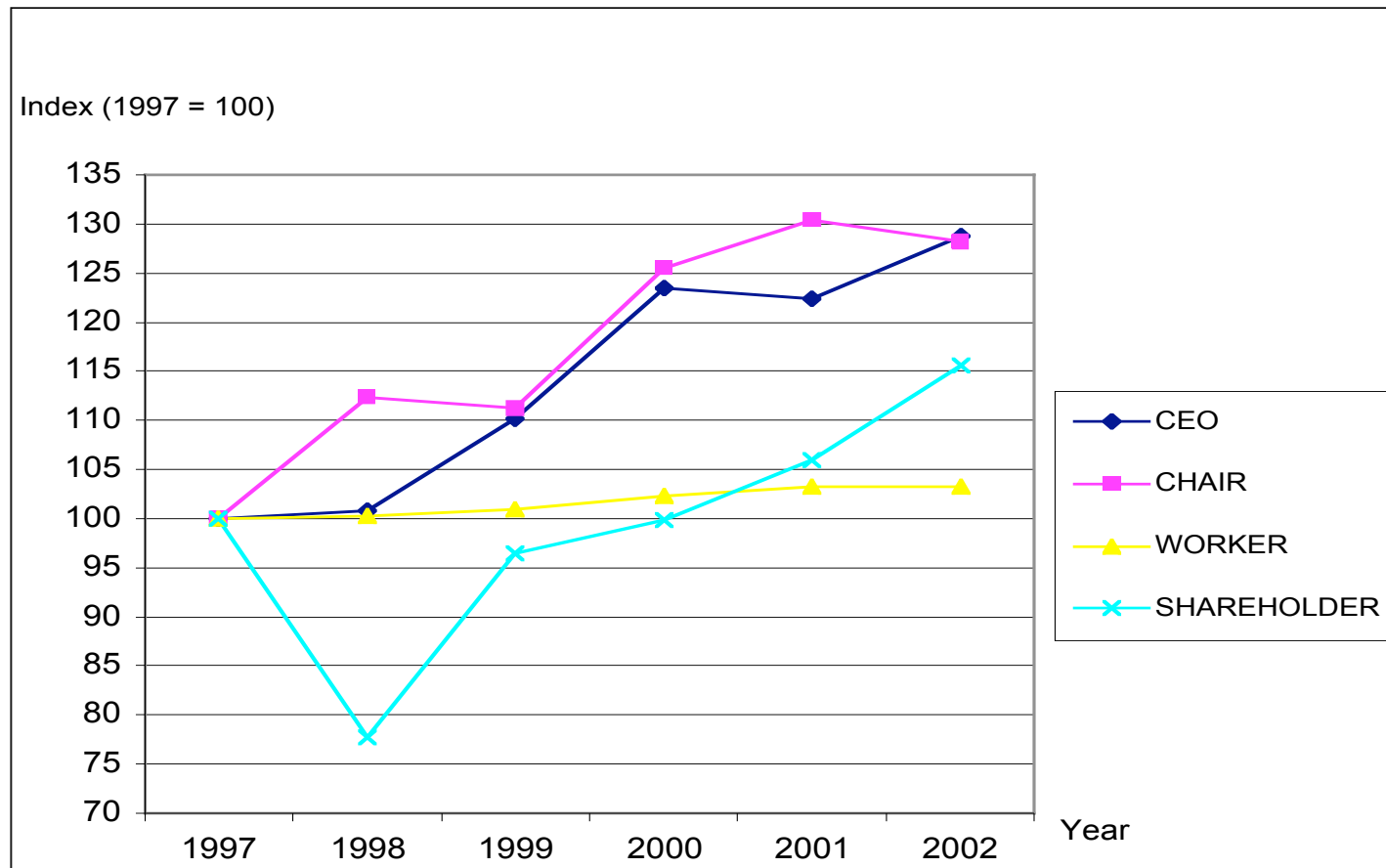
Year	Mean (\$000)	Median (\$000)
1997	40.3	35.0
1998	43.8	40.0
1999	45.5	40.0
2000	49.5	47.3
2001	53.1	49.5
2002	57.2	50.0
Annual growth rate	7.0	7.1



Distribution of Board Chair Remuneration

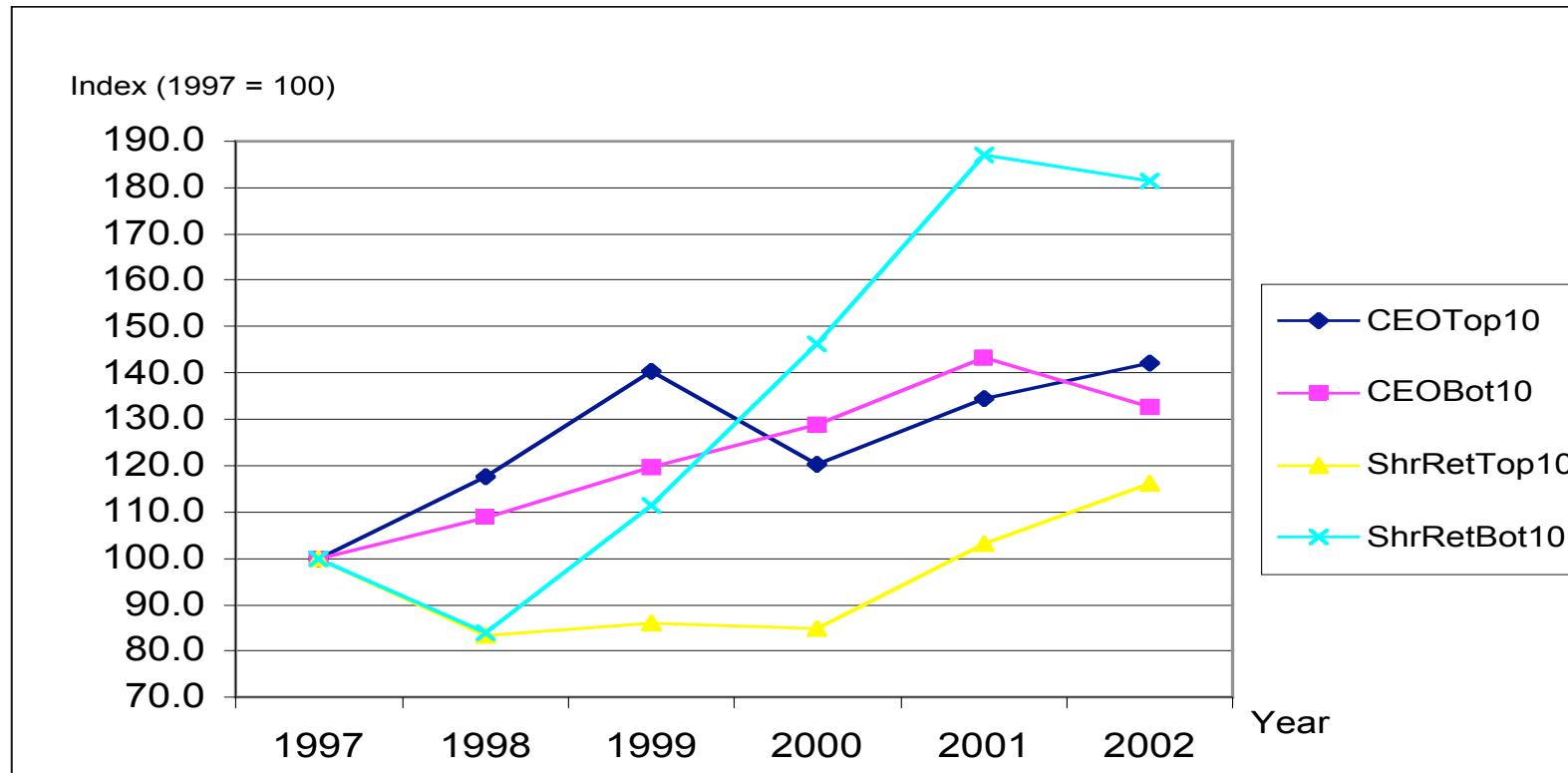


Keeping Up With The Jones's



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Catching Up With The Jones's



Pay-Performance Link

Year	No of Positive Sensitivities (%)	Pay-Performance Sensitivity (\$)	Perquisite Retention (%)
1998	48.4	-0.17	
1999	66.7	0.81	
2000	50.9	0.36	
2001	51.7	0.24	
2002	61.0	0.67	
Overall	55.7	0.30	99.97%



Pay-Performance Sensitivities for Top/Bottom-10 Firms

Firm Category	No of Positive Sensitivities (%)	Pay-Performance Sensitivity (\$)	Perquisite Retention (%)
Top-10	55.3	0.05	100
Bottom-10	58.1	1.57	99.8



Governance 'Principles'

- Jensen, Murphy & Wruck (2004)
 - "Remuneration committees must take full control of the remuneration process, policies and practices."
 - Should have a compensation committee
 - CEO shouldn't be on it
 - "The board should be chaired by a person who is not the CEO, was not the CEO, and will not be the CEO"
 - CEO shouldn't be board chair
 - CEO possibly shouldn't be on board



CEO And Compensation Committee

Year	Firm has Compensation Committee (without CEO)	Firm has Compensation Committee (with CEO)
1997	43.4	3.6
1998	48.9	8.0
1999	54.1	14.9
2000	56.0	16.0
2001	53.9	18.4
2002	64.6	12.7



CEO And Board Chair

Year	CEO is on Board but not Chair (%)	CEO is Board Chair (%)
1997	74.7	6.0
1998	70.5	8.0
1999	71.6	9.5
2000	62.7	16.0
2001	67.1	10.5
2002	64.6	6.3



Pay, Performance and Compensation Committees

	CEO Pay (\$000)	Firm Size (\$million)	Real Return (&%)	Pay Sensitivity (\$)
Firm does not have Compensation Committee	219	27.6	-2.2	0.23
Firm has Compensation Committee with CEO	444	292.4	2.7	0.09
Firm has Compensation Committee without CEO	314	97.2	5.9	0.32



Pay, Performance and Board Chairman

	CEO Pay (\$000)	Firm Size (\$million)	Real Return (&%)	Pay Sensitivity (\$)
CEO is not on Board	258	76.2	9.1	0.30
CEO is on Board but not Chair	302	82.5	1.8	0.26
CEO is Board Chair	231	30.8	-4.0	1.35



Some 'Summary Facts'

1. Growth in CEO pay exceeded inflation, growth in stockholder wealth, and growth in worker earnings
2. CEO pay became more performance-based, but the overall link remained weak: \$0.30 in pay for every \$1000 change in shareholder wealth
3. 1997's lowest-paid CEOs produced better returns to shareholders and had much higher pay-performance sensitivity than 1997's highest-paid CEOs
4. Remuneration Committees increased in number, but so did the presence of CEOs on them



Some 'Summary Facts' cont

5. Large firms were more likely to include a CEO on the Remuneration Committee
6. Firms that (i) used a Remuneration Committee and (ii) did not include the CEO on this committee produced better returns to shareholders and had a higher pay-performance sensitivity than firms missing one of these characteristics
7. The number of CEOs on boards declined, but the number of Chair CEOs stayed about the same
8. Firms where the CEO did not serve on the board produced better returns than firms where the CEO was also a board member.
9. Firms where the CEO was also board chair had the lowest shareholder returns, but the highest pay-performance sensitivity.





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