Executive Compensation Bulletin

Why CEO pay disclosures can be misleading—the example of Singapore

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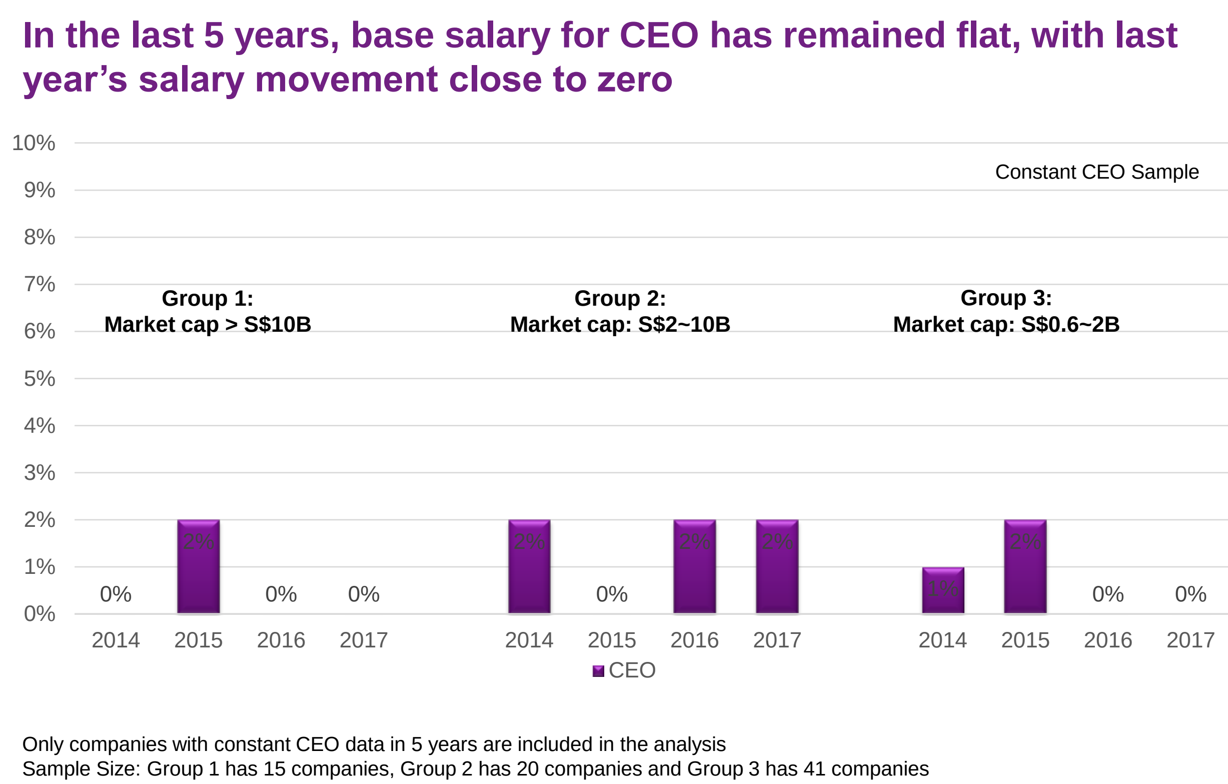
CEO pay can be a sensitive subject. Annual report disclosures and media reports fuel concerns over “run-away” executive compensation. However, this is a complex issue that warrants further attention. In most cases, a quick review of pay disclosures focused on the numbers can be misleading and may not reflect the true value delivered to executives.

Willis Towers Watson analyzed pay disclosures among the largest 120 listed companies in Singapore over the past five years. This article shares some of the common perceptions regarding CEO pay in Singapore (and often elsewhere) and presents analyses to corroborate or dispel the perceptions which we’ve labelled as “busted”, “proven” or “plausible”.

Perception #1: Base Pay is getting out of hand – BUSTED

The general perception is that CEO base pay is growing at least at the rate of general wage increases in Singapore. However, our analysis shows that the base salary for the CEOs of these 120 companies remained relatively constant over the last five years, with the median change in base pay over the last two years close to zero as detailed in *Figure 1*.

Figure 1. CEO base salary over five years



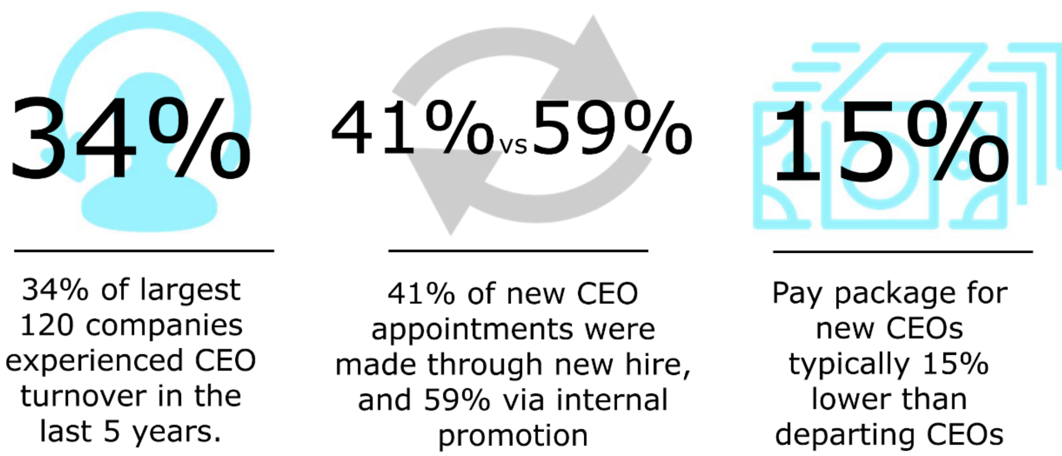
This is largely due to inflationary-based salary increases being more applicable for employees in general, rather than for CEOs and executives. Additionally, muted economic performance has prompted several companies in Singapore to exercise conservatism and freeze CEO base pay.

Perception #2: New CEOs are more expensive – BUSTED

There is a general sense that new CEOs are paid more than predecessors, particularly for external hires.

In Singapore, nearly one-third of the largest 120 companies went through a CEO transition within the past five years. Interestingly, the research suggests that new CEOs were paid approximately 15% lower than previous incumbents (*Figure 2*). This finding differs from similar research done in other markets. However, consistent with findings in other markets, it is true that in Singapore external CEO appointments received higher pay packages than internal promotions.

Figure 2. Findings for new CEOs in Singapore

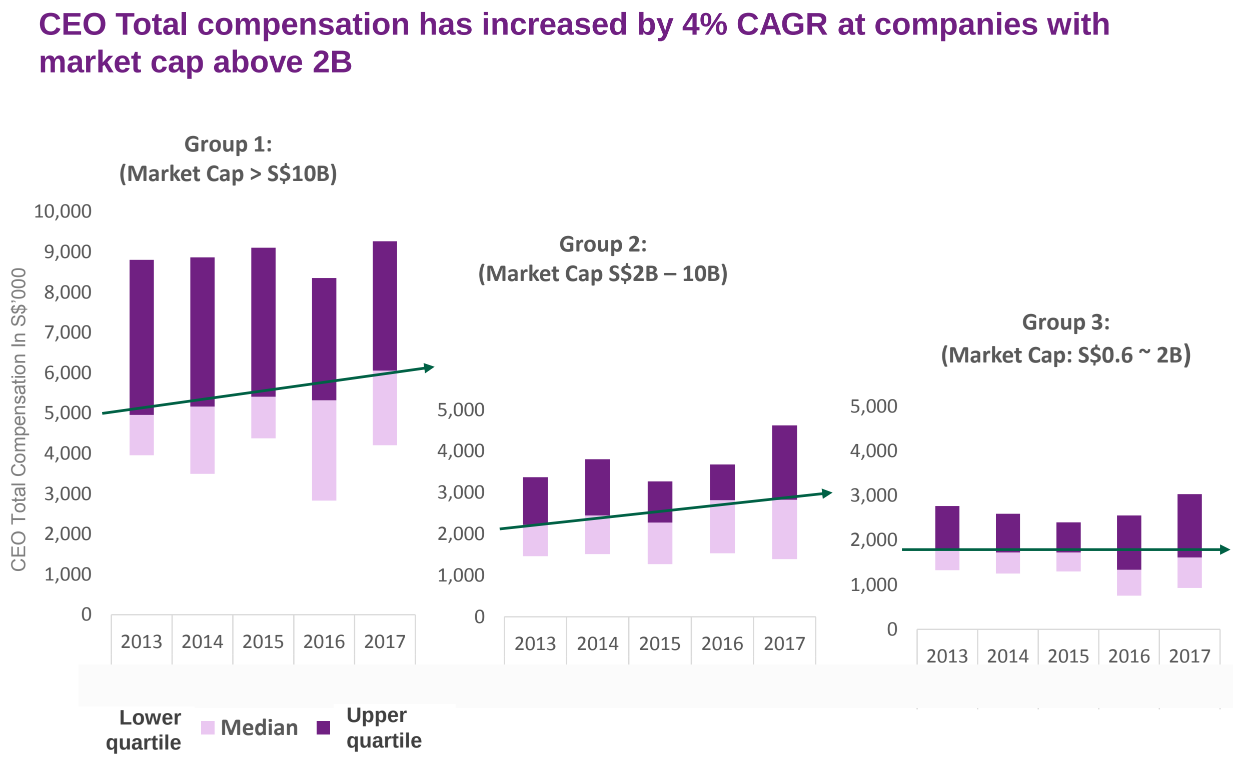


Perception #3: CEO pay has increased over time - PROVEN

Indeed, over the past five years, CEO pay in Singapore has grown by approximately 20%.

Total executive compensation includes base pay, short-term incentives (STI) and long-term incentives (LTI). Stable base-pay figures affirm that variable incentives, especially LTI plans, account for most of the increase in CEO total compensation (*Figure 3*). Long-term incentives at companies listed in Singapore are typically awarded in the form of stock options and performance-based shares. Time-based share awards are prevalent in the U.S. and U.K. markets, but not in Singapore.

Figure 3. CEO total compensation by size



That said, while the value of total compensation at the time of grant may have increased, the cash value actually delivered to executives — the "take home" value of pay — may not have, as we shall detail.

Perception #4: Equity and LTI plans are making executives very rich - BUSTED

In our proprietary study, Willis Towers Watson collected detailed information on the LTI plans (performance share plans) of Singapore companies over the past five years, and the findings are quite interesting:

- Only 48% of the performance share plans granted three years ago have met threshold performance conditions, meaning that more than half of awards expired worthless.
- Of the companies that had some vesting, median vesting was approximately 50% of the target award (above threshold, but well below target).
- At 90% of the companies, the value at vesting was below 85% of the initial reported value at time of grant (this decline in value also reflects changes in share price over the same period).

Overall, for every $100 worth of reported LTI granted in Singapore over the past five years under performance share plans, executives took home only approximately $25.

Perception #5: Singapore companies practice pay-for-performance alignment – PLAUSIBLE

How have Singapore listed companies performed over the past five years? From a shareholder value perspective, the *Straits Times* Index suggests that performance has been flat – share prices are almost at the same level as five years ago. We also looked at economic value added (EVA), which is calculated by deducting each company's cost of capital from its net operating profit after tax; and nearly half of the companies registered a negative EVA in the latest financial year.

Against a backdrop of a 20% increase in the disclosed value of CEO pay over the past five years, it would appear that the alignment between pay and performance has not been very strong. However, a closer examination reveals a different answer.

Let's take the example of Company ABC, a real constituent of the *Straits Times* Index which we will not identify. We looked at CEO total compensation information disclosed in ABC's annual report to understand the linkage between CEO variable pay and performance, especially LTI awards (*Figure 4*).

Figure 4. Company ABC CEO total compensation in the last five years (in Singapore dollars ('000)

	Annual Fixed Pay	**Short-term Incentive**	**Long-term Incentive *Grant value**	**Total Compensation** (disclosed in annual reports)
	Base Salary, Annual Wage Supplement, Car Allowance	Performance Bonus	Performance Shares	
2013	1,000	2,000	**2,000**	5,000
2014	1,000	1,900	**2,200**	5,100
2015	1,000	1,800	**2,500**	5,300
2016	1,000	1,700	**2,800**	5,500
2017	1,000	1,600	**3,000**	5,600

In the example above, STI received by the CEO has dropped from $2 million Singapore dollars in 2013 to $1.6 million in 2017 as the company's net profit dropped from $810 million to $500 million Singapore dollars. The LTI granted to the individual has increased over the years, from $2 million Singapore dollars (or 40% of CEO total compensation) to $3 million (or 54% of CEO total compensation).

However, it is important to note that LTI's value disclosed in annual reports is the grant value, estimated using the contingent number of shares granted to the executive and fair value of the shares on grant date. This is the opportunity that the CEO could potentially earn if the company achieves the three-year performance conditions set by the board.

At the end of the performance period, the number of shares vested to the executive may be very different to the grant value, as the award is adjusted based on the company's performance achieved during the period and the associated achievement factor. This is defined as realized value, the number of shares actually vested at the end of the performance period, multiplied by the share price upon the vesting date.

As such, the realized value could be very different from the grant value. If the company exceeds the performance target or the stock price goes up, the realized value can be higher than the grant value. On the other hand, if the company does not meet the threshold performance target, the realized value could be zero (no matter what the stock price does). Hence, a quick review of the grant values reported in annual reports may not truly reflect the notion of pay for performance.

This is what happened with Company ABC. In 2015, the CEO was granted $2.5 million Singapore dollars worth of LTI. At the end of the three-year performance period at the end of 2017, the company did not meet the threshold performance level set for the plan, and therefore the realized value for the LTI was $0 (i.e., no shares vested).

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Figure 5. Company ABC CEO total compensation (earned value vs. realized value) (in Singapore dollars ('000)

	Total Cash (Annual Fixed Pay + Annual Bonus)	Performance Share Grant value (estimated in that year)	Total Compensation Earned (based on grant value)	Performance Share (realized value based on performance in last three years)	Total Compensation Realized (based on performance share realized value)
	(1)	**(2)**	=(1)+(2)	(3)	=(1)+(3)
2013	$3,000	$2,000	**$5,000**	$2,500	**$5,500**
2014	2,900	2,200	**5,100**	2,200	**5,100**
2015	2,800	2,500	**5,300**	1,000	**3,800**
2016	2,700	2,800	**5,500**	500	**3,200**
2017	2,600	3,000	**5,600**	0	**2,600**

The CEO's total compensation disclosed in the annual report for 2017 was $5.6 million Singapore dollars, however, actual take-home pay was only $2.6 million; this was much lower than previous years, reflecting the company's below target performance.

Under the veneer

So, in summary, annual report disclosures may suggest that CEO pay levels in Singapore are increasing and initially may seem misaligned with company performance. However, a careful reading of annual reports and other pay disclosures, coupled with analyses of actual payouts over time, suggest that properly formulated LTI performance measures can help provide strong alignment between take-home pay and company performance. Importantly, it appears that over the past few years, many Singapore listed companies have been doing a good job of tying executive rewards to robust performance standards. Consequently, the take-home (or realized) pay of CEOs in Singapore has not increased disproportionately.

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