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SA's executives deliver value for money

FAIR

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The JSE's Top 10 Overpaid CEOs for 2012

Company	CEO	JSE Sector	Total remuneration (Rands)	Remuneration per point of ERetShF* (Rands)
Northam Platinum Ltd.	Glyn T Lewis	Mining	11 106 000	(2 544 913)
New Bond Capital Ltd.	Andrew D Bonamour	Equity Investment Instruments	10 045 000	(692 281)
Group Five Ltd.	Mike Upton	Construction and Materials	8 844 000	(559 322)
ArcelorMittal Ltd.	Nonkululeko M C Nyembezi-Heita	Industrial Metals and Mining	8 033 190	(1 681 991)
Allied Technologies Ltd.	Craig G Venter	Mobile Telecommunications	8 003 000	(222 367)
Sentula Mining Ltd.	Robin Berry	Mining	6 558 000	(256 312)
JCI Ltd.	Peter Gray	Mining	5 077 000	(352 080)
Huge Group Ltd.	James Charles Herbst	AltX	4 841 606	(80 693 433)
Merafe Resources Ltd.	Zanele (Joyce) Matlala	Mining	4 750 000	(1 276 196)
Hulamin Ltd.	Richard Jacob	Industrial Metals and Mining	4 677 156	(3 105 681)

Notes: * ERetShF: Excess return on shareholders' funds, in percentage points.

The JSE's Top 10 Underpaid CEOs for 2012

Company	CEO	JSE Sector	Total remuneration (Rands)	Remuneration per point of ERetShF* (Rands)
Ascension Properties Ltd.	Ashraf M Mohamed	Real Estate Investment and Services	700 000	53 191
Putprop Ltd.	B C Carleo	Real Estate Investment and Services	747 000	52 260
ISA Holdings Ltd.	Clifford S Katz	AltX	1 418 437	49 934
Total Client Services Ltd.	Lindikhaya Sipoyo	AltX	2 183 289	49 591
Imbalie Beauty Ltd.	Esna Colyn	AltX	438 000	29 627
Marshall Monteagle PLC	David C Marshall	Support Services	258 000	29 621
New Europe Property Investments plc	Martin J C Slabbert	Real Estate Investment and Services	168 000	23 776
Pan African Resources PLC	Jan Nelson	Mining	597 468	22 245
M&S Holdings Ltd.	Francois Fouche Goosen	AltX	1 018 000	21 747
Netcare Ltd.	Richard H Friedland	Health Care Equipment and Services	11 798 000	12 918

Notes: * ERetShF: Excess return on shareholders' funds, in percentage points.

Source: Labour Market Navigator

SOUTH Africa has some of the best-run companies in the world. According to a recent study in the Labour Market Navigator, published by Prophet Analytics, the real risk-adjusted return on capital of South African listed businesses is currently 10 percent – the highest in the world.

In some notable areas, including corporate transparency and board effectiveness, South Africa ranks number one in the world. The proportion of South Africa's national income that is attributable to private business enterprises in the form of profits (as opposed to households in the form of wages) rose from 39 percent in 2000 to 51 percent last year.

South Africa's private sector, measured by such dimensions as the degree of business sophistication, is ranked 34th in the world, alongside Ireland, Chile and Israel. The country's professional management is ranked 13th in the world, alongside Denmark and Canada. As these results show, South African companies are vibrant, innovative and competitive and can stand up to comparison with any company in the world. Yet the remuneration of South Africa's managers has come under fire from many quarters.

Trade unions have begun to cite chief executive remuneration – particularly the gap between the pay of a company's chief executive and its average worker – in workers' annual pay negotiations. Politicians have called for chief executive remuneration to be capped in future.

Yet none of these claims mention the rational basis for chief executive pay, namely corporate profitability. In theory, chief executive remuneration should be linked to corporate financial performance. This means some chief executives are likely to be appropriately paid (or even underpaid) given their firms' performance, while others may be overpaid on the same basis.

Last year, we introduced a quantitative measure of company performance and related that measure to chief executive remuneration for 212 JSE-listed firms. In that study, we found that chief executive remuneration was not generally justified by company profitability: the overall correlation between chief executive remuneration and company profitability was just 23 percent. We also found a significant degree of variation between companies.

For example, Investec chief executive Stephen Koseff's remuneration was R30 736 385 above the economically justifiable level, whereas Anglo American chief executive Cynthia Carroll's remuneration was R17 171 000 below par.

We speculated that two factors conspired to raise chief executive remuneration in South Africa, namely immigration controls for high-skilled foreigners, which have created an artificial shortage of company executives; and new technologies, which have raised the demand for executive expertise. This year, we expanded our sample to 230 companies, as a result of improvements in company reporting of executive remuneration.

Unfortunately, company reporting of share-option remuneration is patchy and incomplete, with no consistent practice, but we expect this to improve in coming years. This year, we kept the same basis as last year for measuring corporate profitability, namely the excess return (over the market return) on shareholders' funds.

In this report we found that South African firms were among the best performing in the world, with the result that chief executives' performance bonuses tended to be substantial. We also found the relationship between chief executive pay and corporate profitability had improved: more managers were being explicitly rewarded for corporate profitability, both in cash and through the use of stock options.

Unfortunately, many companies still have a long way to go before their executive remuneration strategy provides the correct incentives. The factor over which chief executives have the most direct control is corporate earnings, particularly in relation to the amount of shareholders' funds employed to achieve those earnings.

For example, for the second quarter of last year, mining firm Assore generated a return on shareholders' funds of 35.7 percent. The equivalent return for the average company over this period was 4.8 percent and Assore's three-year beta at the time was 1.14, which yields a risk-adjusted benchmark return for Assore of 4.8 percent multiplied by 1.14, to equal 5.5 percent.

Assore generated an excess return on shareholders' funds of 30.2 percent (35.7 percent minus 5.5 percent). To achieve this return, Assore paid chief executive Christopher Cory R20 623 000, being R4.5 million in basic pay and R16.1m in performance-related bonuses.

Using this methodology, the most overpaid chief executive in South Africa is Esorfranki's Bernie Krone, who was paid R2.9m and generated a return on shareholders' funds of 1.94 percent and an excess (over the market) return on shareholders' funds of minus 0.03 percent. This means Krone was paid very much in line with the average chief executive (he had the 137th highest remuneration among this group of chief executives) to deliver a very poor return on shareholders' funds.

Interestingly, Krone's performance bonus for the year was just R225 000 (7.7 percent of his total remuneration for the year) – presumably a token amount, in relation to the poor overall performance of the firm. The most underpaid chief executive in South Africa is Netcare chief executive Richard Friedland. Friedland was paid R11.8m and generated a return on shareholders' funds of 916.3 percent, being an excess (over the market) return on shareholders' funds of 913.3 percent.

Interestingly, Friedland's performance bonus of R5m (being nearly half of his total remuneration for the year) reflected the spectacular performance of the firm – and indeed, if Friedland were paid on a fair basis relative to other chief executives, his performance bonus would have been substantially higher.

Interestingly, the most dramatic change since the previous year has been the improvement in the relationship between corporate profitability and chief executive remuneration, which now has a correlation of 30 percent, compared with 23 percent the year before.

This suggests profitability has increased in significance as a determinant of chief executive pay, while other factors such as executive tenure, the number of employees and the value of assets under management have decreased.

This is an encouraging development, since corporate profitability is the sole rational basis for executive remuneration levels.

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