

# ABSTRACT

## PAY ON PERFORMANCE?

### ANALYSIS OF 2012 REMUNERATION IN ITALIAN LISTED COMPANIES



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independent, local, expert

## Purpose and methodology

The remuneration policy is one of the strongest corporate governance tools, aimed at defining the main targets of the beneficiaries and motivating them to pursue the main goal of all listed companies: the long-term sustainable value creation. The Frontis Governance's report analyses in deepest details all the remuneration components of the **CEOs and the Board members at largest 98 Italian** listed companies. The purpose of the study is not to define whether an overall compensation is too high, but, as the title states, to evaluate its real alignment to the company's goals: are remunerations effectively structured to pay the performance?

In order to correctly compare the Directors' compensation with past performances, the analysis takes into account the vested remuneration components, that are:

- all **cash amounts** paid during the fiscal year: base salary, annual bonus, deferred and long-term incentives, benefits and all other monetary compensations;
- **shares granted**, based on the market price on the vesting date; the awarded components that did not vest are excluded, as often subject to future performance conditions;
- the value realized from the exercise of **stock options**; non-exercised stock options that vested during the year are excluded from 2012 remunerations, as the relevant value will depend on future stock market performances.

In order to keep as much homogeneous as possible the comparison of different remuneration structures, eventual severances paid in 2012 are excluded from the analysis. Although severance clauses are a critical aspect of any remuneration policy, often representing a real disincentive for the management to pursuit the company's interests, it is an extraordinary compensation mostly linked to external factors, such as national labour contracts or individual agreements. As the scope of the analysis is to evaluate the remuneration policy as a governance tool, aimed at creating long-term sustainable value, all indemnities paid in 2012 are separately reported at the beginning of the study.

## Contents and structure

All the remuneration components, paid in 2012 by 98 Italian large and mid-caps, have been analysed by their **nature** (cash, shares or stock options) and relevant **vesting period** (fixed salary, annual bonus and long-term incentives), in order to compare each amount through appropriate parameters: company's size, operating results and stock market performances, achieved the previous year and in the long term.

Once having analyzed the average remuneration structure by industry, and verified the eventual correlation with the company's size and performances, the study is focused on 38 Italian components of the FTSE MIB index. Each part of the CEOs' remuneration is **compared with relevant key parameters**: market capitalization, revenues, average wages, operating results and total shareholders' return in 2011 (when related to the annual bonuses) and in the 2009-2011 period (when related to the long-term incentives).

All 2013 Remuneration Reports issued by the largest Italian companies are scrutinized, highlighting the critical aspects that may lead institutional shareholders to a negative vote: quality of the disclosure, structure and nature of variable components, eventual discretionary bonuses and *ex post* correction mechanisms (claw-back or *malus* clauses).

Finally, the remuneration structure of each major Italian company is **compared with a group of European peers**, selected by size and industry in order to replicate the FTSE MIB composition. All data related to European issuers are taken from the ECGS database. ECGS ("Expert Corporate Governance Service") is the only international network of local proxy advisors, including: Proxinvest (Managing Partner – France), DSW (Germany), Ethos (Switzerland), Frontis Governance (Italy), GIR (Canada) and Shareholder Support (the Netherlands).

## Main results of the analysis

- The overall 2012 CEOs' compensation at 98 largest Italian companies **increased by 27.5%** versus 2011. The growth is higher, +31.3%, in the FTSE MIB components.

The trend is exclusively **due to the long-term incentives** that vested during the year (+150% versus 2011) and ascribable to only 4 companies and 3 managers: the CEO of **Fiat** and executive Chairman of **Fiat Industrial**, Sergio Marchionne, received free shares for an aggregate value of € 40.7 million on the vesting date; the CEO of **Yoox**, Federico Marchetti, realized € 23.55 million from the exercise of stock options; the CEO of **Luxottica**, Andrea Guerra, received approximately € 10 million in shares (market value on the vesting date).

- The **base salary** represents the main component of the CEOs' remuneration at mid-cap companies (51%), while its weight decreases to 35% in the 38 large-caps. It is not possible to verify **any correlation** between market capitalization and fixed components, that are at the highest levels in Europe: only the Spanish and Portuguese average base salaries are higher than the Italian ones, while the lowest average has been recorded in the British peers included in the sample, despite the much higher market capitalization.
- **Annual bonuses** paid in 2012 seem to be independent from **any performance criteria**, both in terms of operating results (EBITDA, Tier 1 Ratio, Solvency Ratio, Net income or Dividends paid) and shareholders' value (TSR 2011). Such outcome is also due to **discretionary bonuses** (entry bonus, extraordinary bonus or retention bonus), that are still provided by 37% of remuneration policies.

Furthermore, almost all Italian listed companies paid the annual bonus **entirely cash**, while the bonus awarded by 71% of analysed European peers also included financial instruments (shares and stock options), that tend to enhance the alignment of interests between management and shareholders. Nonetheless, the short-term incentives paid by Italian companies represented 14.4% of the overall remuneration, much less than 30.7% recorded in European peers.

- It is not possible to verify a clear alignment of **long-term incentives** and the value created in the medium-long term. The **TSR** realized by Italian large caps in the 2009-2011 period was **+14.5%**, while 2012 long-term incentives, mostly based on the same vesting period,

represented **143.6% of the CEOs' base salary**: the top managers' revenues are much higher than the value created to shareholders.

Considering the aggregate incentives vested in 2011 and 2012, it is possible to verify a correlation on the extremities: higher incentives have been paid by companies with better 2009-2011 TSR performances, while no incentives tend to vest in companies that achieved the worst results.

On the other side, long-term **incentives are much more in line with operating performances** realized over the last three-years period.

In conclusion, long-term incentive plans are generally **adequately defined** to pay the (operating) performance, but the amount seems to be **disproportionate** respect to value created.

- The introduction of the shareholders' vote on remuneration policies in 2012, even if not binding (except for banks and insurance companies), strongly enhanced the level of **transparency on executives' compensation**. More than 70% of 2013 Remuneration Reports duly disclosed the long-term incentives' performance criteria, while the transparency is still quite poor on annual bonuses. Furthermore, several companies substantially modified their policies, thanks to a closer dialogue with institutional investors.
- The deep gap between shareholders' interests and officers' compensation is still not filled, but it seems that things are moving in the right direction. The analysis of 2013 Italian AGMs confirms the positive results of the *say-on-pay*: the independent shareholders' dissent on Remuneration Reports **decreased by 17.3%** in 2013, to 30.2% from 36.5% in 2012, first year of implementation of the new rules.

THE FULL REPORT IS AVAILABLE HERE: <http://www.lulu.com/spotlight/frontisgovernance>

Frontis Governance was born on September 2011 as the first proxy advisor completely focused on the Italian market. The mission of Frontis Governance is to provide a professional and independent support to all minority shareholders in exercising their shareholder rights and in analyzing the corporate governance in investee companies.

Since its birth, Frontis Governance joined ECGS (Expert Corporate Governance Service), the only international partnership of local governance experts, in order to provide the most accurate and specialized local market expertise also on foreign markets. The other members of the ECGS' network are: Proxinvest – Managing Partner (France), DSW (Germany), Ethos (Switzerland), Shareholder Support (Netherlands) and Group Investissement Responsable (GIR – Canada).

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