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Pay strikes the wrong chord

2023 AGM Season

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Summary of 2023

AGM outcomes

This 2023 AGM season saw shareholders making their presence felt on a range of matters, resulting in significantly higher remuneration report strikes, and with it 'against' votes.

After a relatively subdued year in 2022, the 2023 AGM season has seen significantly heightened scrutiny on pay practices and outcomes as shareholder views are voiced loudly to Australian companies and their Boards. As the number of strikes increased considerably this year, so too did the average 'against' vote. Such outcomes reflect the ongoing expectation for alignment between pay and performance, supported by holistic decision making processes that appropriately weights reputational, risk and behavioural performance alongside more traditional financial and non-financial markers of company achievement.

23 organisations within the ASX 200 received a strike (>25% vote against their remuneration report) in 2023 (see Figure 1), nearly double the number of strikes seen in 2022. Whilst the majority (85%) of ASX 200 companies avoided a strike (down from 92% in 2022), this figure represents the highest number of strikes observed in the ASX 200 in more than 7 years.

The average % vote against remuneration reports in the ASX 200 has also significantly increased, to 12.50%, as compared to 6.52% in 2022.

Seven companies received an 'extreme' vote against their remuneration report of greater than 50%, compared to only one in 2022. Further, three of these companies received a no vote of higher than 70% (Qantas, Harvey Norman & Lovisa).

To buck this trend, no ASX 200 companies received a second strike against their remuneration report in 2023. Two companies in the ASX 200 received a third strike (Dicker Data & Lovisa), which does not trigger a spill of the Board, as the counter resets after the second strike. Four companies experienced strikes this year after a 'near miss' (a vote 'against' of between 15% to 24.99%) in FY22, indicating that concerns from the previous year were not sufficiently addressed.

Similar to prior years, stakeholders continued to pay close attention to those whose pay practices were out of kilter with the broader market, or misaligned with the shareholder experience. The consideration and appropriateness of discretion remained a key expectation, as stakeholders continued to agitate for increased transparency in pay and governance practices, alike. One-off or retention awards remained very unpopular (even if tied to considerable time-based conditions), irrespective of the rationale provided for their use. Meanwhile, responses to the use of restricted equity in incentive structures were more positive, often being applied to compensate for significant increases in deferral periods (and therefore value) as a result of financial services regulation.

The majority of strikes had some identifiable remuneration-related issues, with a misalignment between pay and performance a highly prevalent factor, especially for companies who experienced lower financial performance in FY23 or below expectations. Demonstrated through the high prevalence of 'extreme' votes against, shareholders made their presence felt on a number of issues, of which notable examples have been provided below:

- **Qantas Airways Limited (83% 'against'):** High CEO pay and inappropriate management bonuses were flagged against a backdrop of material operational and governance issues. These concerns were compounded by the market perception of insufficient Short Term Incentive (STI) disclosures, and an inconsistency with common market practices in the structuring of the Long Term Incentive (LTI) plan.
- **Harvey Norman Holdings (82% 'against'):** Concerns were voiced regarding a misalignment between pay and performance in light of reduced company financial outcomes, alongside fixed pay increases to executive remuneration despite pay being above median (as defined by external stakeholders), a lack of rigour in STI targets and insufficient transparency relating to pay practices.
- **Fortescue Metals (52% 'against'):** The repeated use of discretion to provide special recognition awards was once again a cause for scrutiny. These came against the backdrop of weaker financial results and declining revenue. Duplication in the inclusion of strategic measures in STI and LTI, and the excessive weighting of undisclosed, non-financial, strategic objectives in the LTI award also were causes for stakeholder concern.

Figure 1

	2023	2022
ASX 100		
% receiving a strike	**12.50%** (10 out of 80)	7.59% (6 out of 79)
Average % vote 'against' rem report (min/max range)	**11.91%** (0.06% - 82.93%)	6.42% (0.01% - 36.6%)
ASX 200		
% receiving a strike	**14.74%** (23 out of 156)	7.69% (12 out of 156)
Average % vote 'against' rem report (min/max range)	**12.50%** (0.06% - 82.93%)	6.52% (0.01% - 55.76%)

1. Results of AGMs held in the calendar year to 31 December 2023. ASX positions based on 3-month average market capitalisation as at 30 September 2023 (excluding REITs and companies domiciled overseas).

Summary of 2023

AGM outcomes (cont'd)

While shareholder and proxy adviser concerns are being voiced louder than previous years, the issues being raised remain fairly consistent.

- ***Misalignment between executive pay and company performance***, often leading to questions regarding the appropriateness of the framework, and/or whether Board discretion was appropriately used;
- ***Insufficient disclosure and transparency*** of pay practices, particularly in relation to metrics, targets and performance outcomes;
- The absence, or insufficiency of context and decision making processes regarding **discretionary adjustments**;
- **Excessive weight on non-financial metrics**, particularly without robust rationale for their inclusion; and
- ***Deviation from commonly observed market practices***, particularly regarding pay quantums and one-off awards (ie. retention grants).

There continues to be divergent views on 'better practice' in the design of remuneration frameworks. As regulated Financial Services companies implement the new APRA requirements, there has been a greater emphasis on non-financial measures, lengthened deferrals and, in some cases, increased remuneration packages. Conversely, other market voices continue to raise concerns particularly where non-financial measures are considered to be weighted inappropriately or in instances where such measures are considered to constitute 'business as usual' requirements of Executives. This criticism highlights the market view that it is not so much the integration of non-financial measures into reward frameworks that remains the point of contention, but rather the appropriateness of the particular measures selected (i.e. is it a key contributor to sustainable shareholder returns?), and the relative emphasis of such, as compared to financial performance.

While the use of non-financial measures are a mainstay in STI plans, their prevalence in LTI plans has remained steady, with over a third (37%) of ASX 100 companies[1] already utilising such metrics. With progression against ESG strategies an increasingly critical concern for many stakeholders, and coupled with the additional focus as a result of FS regulation, we expect prevalence of these measures to increase. Balancing our expectation however, is the growing stakeholder agitation of the appropriateness of ESG metrics, particularly noting that there is not an equal push for their implementation across all industries, with pressure mounting in line with the perceived span of control each company has (ie. environmental impact in mining or risk & governance focus in FS). Further, as such measures become increasingly common, the appropriateness of targets is also being stress tested. This is especially so from an environmental perspective, with stakeholders questioning the relevance of measuring achievement in the short-term, noting the often significant time horizons required for material improvement to occur.

Extreme Strikes: Seven companies received an 'extreme' vote against their remuneration report of greater than 50%, compared to only one in 2022.

Figure 2 ASX 200 Remuneration Voting Outcomes

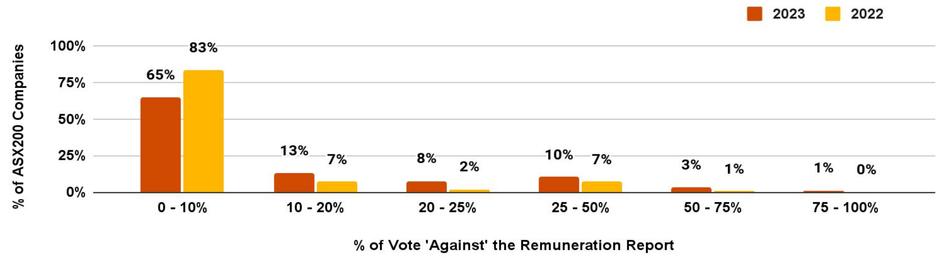
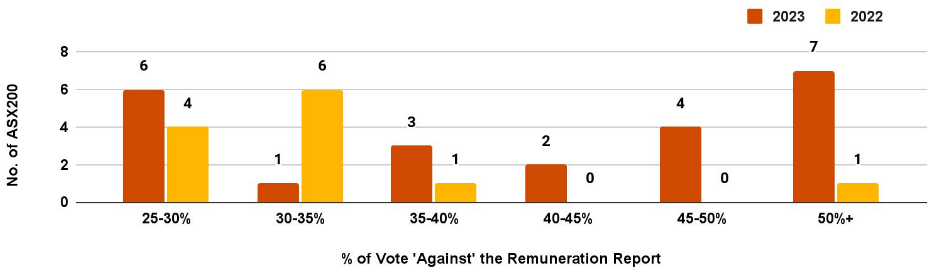


Figure 3 ASX 200 Strikes: Spread of Voting Outcomes



Largest 'no' votes in 2023

- Qantas (83%)
- Harvey Norman (82%)
- Lovisa (73%)
- Magellan Financial Group (58%)
- Champion Iron Limited (54%)
- Fortescue Metals Group (52%)
- Atlas Arteria (51%)
- Johns Lyng (50%)
- AMP Limited (49%)
- Nufarm Limited (47%)

1. ASX 100 as defined in PwC' 10 minutes on... 2022 executive remuneration trends

Summary of 2023

What the future holds

A new breadth of expectation brings with it an increasing level of scrutiny

There continues to be heightened scrutiny on company performance against financial and non-financial markers of performance (eg diversity, gender pay gap, ESG performance, climate reporting). Some of these are or will have greater levels of disclosure outside of the remuneration framework for example, gender pay gap at an individual company level for those with >100 employees. These measures allow stakeholders to build a more comprehensive and data driven narrative surrounding company performance and their view of the appropriateness of pay outcomes in this context.

However, for companies there is an increasingly tricky balance - shareholders are often looking for companies to demonstrate performance and credentials against multiple dimensions - both financial and non-financial - but they aren't always willing to pay for this performance. And, conversely may expect companies to penalise executives for poor performance against these same measures.

Preemptive actions to be considered by companies

Review the rationale for each metric in the incentive plan, harnessing the power of data to improve target setting

With so much data available to external stakeholders on how organisations are performing, it is now even more important to be able to clearly articulate which metrics most strongly align with strategy, and sustainable long-term performance. This can help underpin a Board's rationale on the appropriateness of a metric's inclusion or exclusion in an incentive plan (and the associated reward outcomes).

As additional disclosures raise the bar for setting transparent and defensible targets, organisations should seek opportunities to leverage (particularly in the case of non-financial metrics) a wealth of historical data and predictive analytics to enhance the rigour in setting targets. Not only can this data be used to more clearly differentiate between 'good' and 'great' performance, it also provides organisations an enhanced ability to describe both 'how' and 'why' targets are set, particularly in the face of increased scrutiny.

Seek to fine tune Board decision making approaches to account for ever-evolving stakeholder expectations

Shareholders expect remuneration outcomes to be able to capture emerging priorities and their impacts on company perception and performance. As a result, the use of discretion has become a mainstay in Australian remuneration practices, as has the articulation of the prescriptive guidelines and processes undertaken by Boards to determine such outcomes, albeit to varying degrees. In recent years, Australia's largest listed companies and those in the Financial Services sectors have led the charge in the articulation of their respective approaches, however, the next steps for Australian companies are somewhat two-speed.

We would expect those at the more mature end of the spectrum, who already have prescriptive (and disclosed) guidelines or principles in place, to now turn their minds to reviewing the efficacy of their approach - fine tuning the inputs to ensure application remains consistent, yet dynamic, where required. Conversely, those who are yet to articulate any such processes should look to introduce them, with recent market precedent and guidance from external stakeholders valuable tools in doing so. While internal approaches are likely already defined, a growing desire for disclosure will see many companies expected to bolster the transparency of remuneration decisions.

Proactively consider how aligned the remuneration outcome narrative is to other markers of organisational performance

Emerging stakeholder expectations and regulatory requirements continue to culminate in a growing remit for Boards, requiring an increasing diversity of skills and experience to sufficiently fulfil their duties. While always having been the case, recent years have seen an increased expectation for Boards and RemCos to proactively consider emerging market priorities as a part of the broader organisational performance context, with stakeholders spurred on by the growing transparency and availability of information. Greater reporting requirements including gender pay gap at the individual organisational level (for companies >100 employees) shine a light and provide quantitative data upon which external stakeholders may pin their views. As such, a growing number of focus areas are being considered externally as the market assesses the appropriateness of pay outcomes, resulting in added complexity to ensure increasingly 'holistic' decision making processes.

In addition, including non-remuneration specific issues, proxy advisor voting guidelines continue to evolve, with ISS and Glass Lewis (GL) articulating shifting expectations, particularly relating to ESG matters. ISS has stated their expectation for a greater focus on Boardroom diversity, seeking ethnically diverse Board representation, while GL will apply a greater focus on human capital management practices (alongside a suite of other ESG matters), focusing on labour and remuneration practices across the organisation, as well as diversity and inclusion initiatives. As the breadth of context that is considered by the market continues to grow, Board assessments of performance must too be enhanced commensurately, ensuring alignment in their considerations with that of the market, at a minimum.

How can PwC help

Contact our Reward Advisory specialists

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- Remuneration reports, disclosure and communications