Арника

Conference
Deloitte and the Moscow Exchange

Motivating top management – key trends and issues

Some thoughts of a non-executive director

Geoffrey Townsend, 11th April 2013

Caveat

I am “billed” as a director of Raspadskaya (which is true)

However,

My comments are not based on Raspadskaya

I have served on the nomination and remuneration committee of a different Russian company

1. Alignment of interest

Since the founding of the very first joint stock companies, the problem of *AGENCY* has existed. Management is separated from ownership.

(The agency problem is in fact much older than joint stock companies – consider managers of the state (Rome, Spanish empire, etcetera) or estate management (landowner and his steward)

- Is the manager acting in the owner's interest?
- The problem becomes "how can the owner motivate the manager to act in the owner's interest?"

Dominant shareholder

Russia always claims to be a special case!

Many Russian company's have a dominant private shareholder; this is normal given the youth of the capitalist economy

Provided that the dominant shareholder's interest is in dividends and the growth of market capitalisation, then his interests are almost perfectly aligned with those of minority shareholders.

Motivation of and control over management is in the dominant shareholder's interest.

Role of the nomination and remuneration committee in a company with a dominant shareholder

- It strikes me that it would be logical for the dominant shareholder to be a member of the committee – maybe even chairman; but this is usually not the case.
- It is to be expected that the dominant shareholder will make his intentions well known to the committee; being realistic, the freedom of the committee is limited.

The committee acts as an advisory body rather than a controlling body

- Encourage good, robust process
- Succession planning going several layers deep; management development policy
- Logical structure to pay structures
- Introduce ideas for discussion based on broad business experience

2. Long-term incentive plan

We played with this in 2007

- Looked at emerging Russian experience and also international practice – e.g. BP which tends to explain its policy very clearly.
- Existing practice was base salary plus bonus (typically 60% of base) tied to relevant KPIs (corporate and personal)
- Idea – additional grant of shares based on meeting KPIs, and requirement to hold these shares for a period of time.
- For legal and tax reasons – structured as issue of share options and a cash bonus (based on KPIs) which should be used to finance the exercise of the options.
- Board included in the option scheme, but without the financing bonus

Maybe not a huge success

After 2007 came 2008!

- 1st year options exercised, and management shared the pain of investors! – so that really was alignment!
- 2nd and 3rd year options “out of the money” – not exercised
- The scheme was discontinued
- However, I am a fan of such schemes. And I think it is good for the board to participate; concentrates the mind!

3. Comments on bankers' bonuses

There has been much comment on bankers bonuses in the west; taking London as an example

Big bonuses for investment bankers are not new; but the publicity is

Before "Big Bang" many of the investment bankers who now receive big bonuses were stockbrokers or stockjobbers and were not bankers at all – and were organised in partnerships

As partners, their capital was at risk. As bankers they can use other people's capital – "Heads I win, tails you lose!"

I used to be a Big 4 partner

- Involved in development of remuneration models
- They were 100% distributions of profit, but with a time delay
- Great care needed to balance solidarity with personal achievement
- Risk of encouraging a very short-term approach and some very bad inter-partner behaviour
- Anglo-Saxon models tended not give adequate weight to long-term or even mid-term development

The End!