Phoenix's policy pays off

The ASX-listed copper company is linking remuneration to performance

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With corporate remuneration practices looming larger as the annual meeting season gets underway, Phoenix Copper Ltd stands out from the crowd. It is explicitly linking chief executive (CEO) business targets to executive pay in a way that allows shareholders to judge performance.

Almost universally, resources companies of the smaller variety (which make up the vast bulk of the sector) offer executive directors some combination of cash and access to capital gains from rising share prices – generally without having to put any capital at risk.

The CEO of Phoenix Copper, an A$8 million (US$7.44 million) explorer looking for copper in South Australia, has been granted performance rights to go with his A$272,500 annual salary. Realising the benefit of the performance rights will depend on him raising an agreed amount of capital, spending a minimum amount on exploration and leaving the company with a minimum cash balance at the end of the 2014 financial year. That outcome is given a 20% weighting.

On this score alone, Phoenix is saying to all those exploration companies steadfastly refusing to tag remuneration to explicit performance standards that they are wrong.

For the head of Phoenix Copper to get more, the share price needs to exceed 50% of the company's peer group. The company needs to have discovered ore-grade mineralisation and must have come up with at least one value accretive project. There must also be zero lost time due to accidents and no environmental incidents.

Directors have given themselves some wriggle room. They can vary the weighting for each of the targets along the way, if they choose to do so. If the chief executive is coming up with the project but not getting the benefit on the share price front, for example, directors can up the weighting on the project by 50% and cut the weighting that would have been attributed to the share price.

Phoenix faces the same difficulty as other companies in deciding how to link remuneration to share -price performance. With the largest share price gains more likely to come from an accident of cyclical positioning than executive achievement, the rationale becomes difficult to explain.

The capital gains in remuneration packages mostly arise from freely distributed stock or options. In the event, for example, that the small resources share price index rises again from its current level a little above 2,000 to 7,000, where it was at the beginning of 2011, many hundreds will become wealthier without having put any capital at risk.

These executives will have given no thought to the less well paid Mario Draghi (head of the European Central Bank) or Ben Bernanke (chairman of the US Federal Reserve) on whose commitment to boost world growth their wealth increment would have been based. To perpetuate the myth, they will claim the gains as a consequence of their own skills and not the result of decisions made elsewhere.

Copper is at core of Phoenix's business

Payments based on some measure of relative, not absolute, performance are supposed to overcome this free ride on the shoulders of Draghi and Bernanke, but there is always a problem with measuring peer group performance.

Are the Phoenix peers, when they are eventually chosen, going to be only those companies with market values under A$10 million looking for copper in South Australia? Will only those companies that have so far been unsuccessful in their exploration efforts be included in the peer group? Shareholders are being asked to commit to a package without knowing answers to these questions.

Subjective judgements about peers can undermine the credibility of the best intentioned remuneration plans. Minimising the extent to which directors can exercise discretion to remove a company from the list of peers or to add one helps support credibility.

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The most objective measure for a company like Phoenix to use for its peer analysis is the median return for all the stocks making up the ASX (Australian Securities Exchange) resources sector. This way, directors do not have to choose. Outcomes will not be affected greatly by outliers. Executives can have rewards graded according to whether they are in the top quartile or something worse.

Share-price-related rewards should also have to demonstrate sustainability. A benefit locked in for 2014 should remain at risk of being taken back if the share-price performance on which it was based is not sustained in the subsequent year or beyond.

Despite these objections to specific parts of the Phoenix remuneration package and bearing in mind that share price performance has a weighting of only 20% in its plan, Phoenix Copper has struck a blow for improved governance. It is calling out all those other explorers fatuously claiming that it is not possible to link pay to management achievement. ▼

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