

Definition of executive compensation business essay



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There is several type of executive compensation. Most compensation plan consists of stock option plans, short-term incentives or bonuses, perquisites, golden parachutes and long-term incentive plans.

Firstly, Stock option plan is an incentive plan in which allow the executives to exercise or purchase stock in their company in the future (within a specific time frame) at or below the current market price. Secondly short-term incentives or bonuses is refer to the payment of bonuses reflects a managerial belief in their incentive value. Next, perquisites are referring to special benefits by a firm to a small group of key executives and designed to give the executives something extra. Furthermore, golden parachute contract is a perquisite that uses to protect executives when their company is being takeover or the executive is forced to leave the firm for other reasons.

1. 2 Usage of Executive Compensation for a growth company

The reason of executive compensation for a growth company is because the skills possessed by company executive largely determine whether a company will earn profit, survive, or fail. Therefore, a company's program for compensating executives is a critical factor in attracting and retaining key employees. In general, the higher the managerial position, the more difficult it is to define job tasks. The description focus on the anticipated results rather than tasks or how the work is accomplished. Thus, market pricing may be the best general approach to use in determining executive compensation.

1.3 The evolution of for executive compensation

Pitfall of the economic results the enhancement of a strong public resentment of overabundant bonuses for companies. In light of, the financial crisis will occur is due to the failure of the company to take account on the risk management before setting up the executive compensation packages. Besides that, the strict disclosure requirement impose by the Government regulators showing there is an international trend toward greater regulation of executive compensation practices. Furthermore, the governance guidelines and “say on pay” requirements which established by shareholder advisors will normally increased the shareholder engagement in the process. It shows that the accountability for directors and compensation committees is being heightened in the setting of the compensation strategies for their companies. Moreover, the new guidelines make evolvement on executive compensation practices, and yet the first principles of executive compensation continue to be the same: to attract, motivate and retain the top talent. Referring to the regulators, the design of the executive compensation will be satisfied when it met those first principles and depend on the minimising the risk of the business. Likewise, fail to plan on the tax structure will indicate undesired tax treatment for the executive as it did not satisfying those principles and normally it will indicate substantial costs to the company which compensating the tax burdens from the executive’ compensation.

At here, our aim to investigate the study on Executive Compensation is to help analysing the effects of the executive compensation package and then proposing a suitable Executive compensation plan to the research company

to ensure a significant improvement on the performance and the growth of the company.

Journal of “ Executive Compensation Trends for 2009: Balancing Risk, Performance and Pay” are to study about the relationship between Drop in stock price and changes to executive compensation programs. This research used the survey data from 200 largest companies (by market capitalization) of the S&P 500 Index is to study the market capitalisation, revenue and industry classification. From the research, we found that the data shows the one half of all companies reduced executive salaries by 6 percent, froze salaries by 7 percent; eliminate merit increases by 49 percent. Besides, it also indicate changes to STI Plan by 25 percent, changes to LTI Plan by 39 percent, and changes to severance, perquisites or retirement plans 15 percent. As a result, there has been a shift away from long term incentives and more focus on short term incentive plans. It shows that they much more focus on short-term cash flow, the reliance on the restricted stock which is not performance based.

Journal of “ Determinants of CEO Cash Compensation In Small, Young, Fast Growing Firm” is the study about the relationship of the Growth of the Company and the executive compensation. This research used a survey sample of relatively small, young, and fast-growing firms we begin with the 1999 Compustat active research file. In the research, the authors try to eliminate the undesired constraint data for them to focus on the desired information. The survey data shows that CEOs compensation is affect by few factors like founder, market to book, and financial leverage. From the firm aspect, the founder CEO is more likely to have stayed beyond his or her <https://assignbuster.com/definition-of-executive-compensation-business-essay/>

useful tenure when the firm is large, more mature; selling many products is many industries and geographical markets while founder CEO for small, young and growing firms have not yet established a significant record of performance and find it more difficult to negotiate a greater cash salary. From the research, we found that there is a significant relationship and directly effects between executive compensation and the size of the company. However, the founder have negatively related to the compensation, where the founder of the firm willing to accept lower compensation to be CEO. For the market to book is positively related to CEO compensation if the firm is consistent relatively high growth , then compensation will be highly compensate to CEO for bearing greater employment and equity risk. Another factors that affect the CEO compensation was the firm financial leverage which have negatively related when the firm facing the financial problems the CEO compensation will reduced as well.

Journal of “ Compensation, Reward and Retention Practices in Fast Growth Companies” is the study about the relationship between the Growth of the companies and the CEO cash compensation. This research data is collected through the interview with the CEOS and Others executives of fast growth organization. This research is about the “ how and why” of talent management during challenging times. From the research we found that a group of companies in the United States evolved their compensation, reward and retention practices and the executive leaders are willing and able to make changes to adapt to different challenges and opportunities as they move from startup to sustained growth. Besides, a strong startup hiring

strategy of stock option and signing bonuses did not have retention valve, did not necessarily relate to an individual's value and didn't reward or retain high performing key talent who possess the company's core competencies for the sustainable longer term. However, talent retention is critical importance for fast growth companies. The research result shows that fast growth companies are linking messages communication involves not only updates on the company's performance but also show how people can influence it and gain from it as well as how an individual is doing besides, the company's competitive base pay was set according to standard and fair system. Furthermore, most of the companies were pay above market for their key talent as they want to retain the high performance top talent which able to ensure the stability of the company growth and performance.

Journal of " Executive Compensation and Business Policy Choices at U. S. Commercial Banks" are the study about the relationship between the corporate risk taking to be controlled and the proper incentives into executive compensation contracts. This research used the survey data based on the intersection of the ExecuComp database and the Federal Reserve Y9C database and a relatively small number observation on the databases. From the research, we found that there is a strongly infer that the banks' business policy choices and risk profiles are influenced by CEO wealth incentives. Besides, CEO with high pay-performance incentives tends to expand investment in lower risk activities. It shows that executive compensation will increase as they are able to help in the growth of his organisation. By doing so, it is an advantage for the organisation to control the performance and the compensation of the executive, and this will help in minimising the risk

profile of the organisation. So executives had to take more responsibility for the risk-taking incentive given. In contrast, some executives may try getting the other income from non-traditional activities. However, U. S. government intervention will cause to limit the risk-taking incentives in the executive compensation contracts especially financial executive.

Journal of “ Executive pay and firm size in the presence of career concerns and labour market competition” is the study about the relationship among the firm size, labour market equilibrium and the executive compensation. This research used survey data from combine sample of S&P 500 firms for the period 1992, and S&P 1500 firms over the period 1993-2007 and observation from S&P 1500 firm over the period 1993-2006. From the research, the empirical results shows that the CEO effort due to the incentives is highly statistically and economically significant which indicate that a lack of empirical support for the talent assignment models. Besides, it also indicated that the productivity of CEO is extremely sensitive to share price volatility depend on the scale of elasticity. Furthermore, it was determining the executive will not be penalised when during business crisis. The study was that executive compensation will not be affected since the enterprise is depending on the control of the executive.

Journal of “ Say on Pay Votes and CEO Compensation: Evidence from the UK” is to study about the relationship of pay determinants of executive and CEO's compensation. This research is using survey from UK institutional investors, research design and statistics. From the research, we found that say on pay votes had an effect on CEO pay practices. However, the say on pay regime will deter the innovation in compensation practices and result in <https://assignbuster.com/definition-of-executive-compensation-business-essay/>

a “ one-size-fits-all” approach. Besides, it also shows excess CEO pay will cause increase in the sensitivity of CEO pay and lead to poor performance. From the study, there is insufficient evidence to prove that changes in the level and growth rate of Executive pay, after controlling for firm performance and other determinants of executive pay.

Journal of “ Chief executive Compensation and company performance: a weak relationship or measurement weakness” is the study about the relationship between the company performance and the executive compensation. This research used empirical test and survey data to test on the prolong growth in the executive compensation. The research data determining the measurement of the dependent chief executive compensation variable used in quantitative studies and investigate the correlation between pay and performance. From the research result, there is a significant positive coefficient for both cash and total compensation – Conyon et al. (2001). However, the long-term incentives are less significant and report a much larger positive coefficient. Besides, there is a significant correlation between both short-term and long-term pay and company performance – McKnight et al. (2000). However, basic pay is predominantly determined by company size. As a result, total compensation is depending on the cash compensation, long term incentives measure and the company size, performance and growth.

Journal of “ Determinants of CEO Compensation Empirical Evidence from Pakistani Listed Companies” is to study about the relationship between the reward system and the CEO compensation. This research is used statistical test and survey sample from the KSE listed companies which had been <https://assignbuster.com/definition-of-executive-compensation-business-essay/>

comprised into 114 listed companies for the period of 2002-2006. In addition, it eliminates the data of financial companies and the other companies for which the data could not be found. From the research data, we found that the firm size, performance, market risk, power, tenure, CEO ownership, and firm growth have been used to determine the compensation of executive. The research result shows a strong relationship between the firm size and CEO compensation. Besides, CEO compensation was more closely related to size of the firm when measured by sales and less related to profits- Robert (1959) and McGuire & colleagues (1962). Furthermore, firm's profitability was positively related to CEO compensation, even ROE was unrelated to the salary but it positively related to the bonuses. - (Finkelstein, Hambrick 1989; Deckop 1988). Agency theory literature also shows that power balance between executives and shareholders determine the CEO pay. In brief, the executive compensation is determined by more than one factor as it will provide broader view of the aspect to set executive compensation.

Journal of " The Determinants of the Relationship between Top Executive Stock-Based Compensation and Performance Measures" is to study about the relationship between the CEO's stock-based remuneration and organizational performance. This research used survey sample and empirical model to test on the top executive remuneration. The research data shows four corporate characteristics (growth opportunity, size, risk and financial leverage) that will affect the top executive stock based remuneration. The research result shows that, CEO's stock based compensation will be relatively (1) more sensitive to the market performance as compare to accounting performance of larger growth companies. (2) less sensitive to market performance and

accounting performance, the larger the size of the corporation. (3) less sensitive to market performance, as compared to accounting performance, the greater the risk of the corporation. (4) less sensitive to market performance, as compared to accounting performance, the larger the leverage ratio of the corporation. In brief, the results show that when the environment is more uncertain, the firm would decrease the linkage between the CEO's stock-based compensation and external performance measures, such as market performance which replace it with the internal performance measures such as accounting performance. In addition, when the financial leverage is higher, the firm would require a decreasing of the agency cost of debt and thus strengthen the sensitivity of the level of the CEO's stock-based compensation with the accounting performances measure as the mechanism of pre-commitment.

Journal of the " CEO compensation, Director Compensation, and Firm Performance: Evidence of Cronyism" is the study about the relationship of a weak corporate governance structure, excessive CEO compensation, and poor firm performance to the excessive director compensation. This research used survey data from standard and poor's Execucomp and COMPUSTAT data sets and hand-collected data. Besides, statistical and empirical test are used to test on the compensation variables. The research data shows that there is a positive relation between CEO and director compensation could exist if the firm is large and complex, and this complexity affects the skill and efforts require by both parties. Besides, director compensation expect to be positively related to the need for firm monitoring and the difficulty of the directors' tasks, which we assume are related to firm complexity and risk.

From the statistical test, there is a strong positive correlation between the compensation of CEOs and directors. While some of the positive correlation between CEO and director compensation is pushed by the values of shares as it shows a positive correlation (0.472) between the director's annual fee and total pay of CEO. The research result shows that there is a substantial positive relationship between CEO and director compensation. Besides, the result showing overcompensation of the director and CEO is related to the underperformance. Nevertheless, perhaps there are evidences of cronyism showing a positive relationship between CEO and director compensation, then the relationship between the performance of organization and extravagant compensation will be negative.

3.0 Case development

The company that was chosen by our group is Occidental Petroleum Corporation.

3.1 Description of Occidental Petroleum Corporation

Our research company is the Occidental Petroleum Corporation (Oxy). It is founded in 1920 and it is one of the largest U. S. Oil and Gas Companies (with the fourth rank). Its business is focused on the exploration and production of oil and natural gas mainly on the United States, the Middle East and Latin America, besides that it also provides comprehensive power marketing and sales in the international market. Furthermore, it also invests into the research and development on the Petrochemicals which are the chemical products derived from petroleum.

Oxy had adopted a standard of Human Resource Practices, which allow them to maintain their company vision and organizational commitment toward the continuous improving process. Oxy are very respect and considerations on the career opportunity and growth for their employees as they had their own Health, Environment, Safety (HES) management systems. It tries to engage, develop and retain all those talented individuals for their business. They take pride as a responsible employer which will offer better working environments in term of comfortable and safety and giving respect to their employees.

Besides, they treat the communities fairly and give equal job opportunity without bias of stereotyping or discriminating. Furthermore, it also provide insight training and development opportunity depend on the needs of the employees' career path. Moreover, Oxy also adopt ongoing workforce planning initiatives to ensure the right policies, procedure and programs taken place to facilitate the workforce-HES policies. In addition, HES system is to ensure the good communication among the personnel as they are entitle to responsible for the Oxy's HES performance and the communities thus Oxy is creating a positive organizational culture that with the belief of Better Health, Better Environment, Safety (HES) and Corporate Social Responsibility (CSR).

3. 1. 1 Product of Oxy

Occidental Oil and Gas

Oil and natural gas exploration and production are Oxy's Core business which engages in U. S., Middle East/North Africa and Latin America. With the advance technology, Oxy had leaded its oil and natural gas market. Besides,

it has made continuously improvement on their strategy and tactic of their business such as focus exploration or strategic acquisition to growth their business.

Midstream, Marketing and Other

While, trading and merchant exchange are the intermediate business of Oxy. They focus on Midstream, Marketing and Other segment which implemented through marketing process to markets their production of oil, natural gas, CO2 and energy. In addition, it also trades around its assets, commodities and securities such as pipeline and storage capacity.

OxyChem

It sub-business (OxyChem) also leading the market of Petrochemical product in North American. The product create are polyvinyl chloride resins, chlorine and caustic soda. Besides it also invest in develop and manufacturing plastics, pharmaceuticals and water treatment chemicals.

3. 2 Human Resource Practices in Occidental Petroleum Corporation

3. 2. 1 Comparison of compensation to Oxy Chief Executive between year 2008 and 2009 and the performance of Oxy in year 2009

The Chief Executive for Occidental Petroleum Corporation (Oxy) is Mr Ray R. Irani. The compensation package for the chief executive includes salary, bonus, perks, and stock.

In year 2008, the salary is \$ 1, 300, 000; however it was decrease in year 2009 which is \$1, 170, 000. While the bonus in year 2008 is \$ 3, 630, 000

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and it increase in year 2009 which is \$ 3, 752, 550. Next, the perks receive by Mr Ray R. Irani is decrease from year 2008 to 2009 with \$1, 849, 627 to \$ 1, 719, 979. Lastly, the stock receive by him is increase if compare with year 2008 and year 2009, which is \$15, 747, 997 in year 2008 and \$24, 758, 827 in year 2009. The total change in compensation is 39% from year 2008 to year 2009. The total return for the company in year 2009 is 38% and its revenue is \$15, 531(mil).

3. 2. 2 Implementation of executive compensation in Oxy

3. 2. 2. 1 Compensation Committee in Oxy

Human Resource Committee which is known as Compensation Committee. Who analyse, give recommend and report the compensation plan and other pay-based plan to the Board and the BOD. They must follow the rule and regulation under their duties, responsibilities and authority that stated in the charter.

There are several purpose for the compensation Committee in Oxy.

Firstly, the compensation committee need to make review and approve on the organisational goals to the Corporation's Chairman and CEO's compensation. Besides, the compensation committee have to make evaluation and make consultation with the Lead Independent Director about the CEO's performance. In fact, those objectives will be determined and approved the CEO's compensation level based on the evaluation.

Secondly, recommendations will be made by the compensation committee to the Board regarding the incentive-compensation plans and equity-based plans for executive compensation.

Besides, the Securities and Exchange Commission required the compensation committee to produce the report on executive compensation and it will be included in the Corporation's annual report.

Next, they also had to govern the stock-based compensation plans of their organisation, including several stock-based plans which are adopted by the Board from time to time.

Duties and Responsibility of the Compensation Committee

The duties of the Compensation committee are to set annual and long-term performance goals for the CEO evaluate. The Lead Independent Director had the authority to determine and approve the CEO's compensation based on the evaluation as long as the CEO's performance did not contrast with the goals and performance of the organisation. Besides annual salaries, bonuses and other executive benefits of will be review by the compensation committee.

Next, they also need to govern the stock-based compensation plans of the Corporation, including the 1987 Stock Option Plan, the 1995 Incentive Stock Plan, and the 1996 Restricted Stock Plan for Non-Employee Directors, the 2001 Incentive Compensation Plan and any other stock-based plan adopted by the Board from time to time. In order to assure the purposes of the Plans are met, periodically review must be implemented to the performance of the Plans and their rules and make any necessary revisions.

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Furthermore, new executive compensation programs must be review on a periodically basis. While the operation of the Corporation's executive compensation programs to determine and check whether the executive performance, and periodically review policies for the administration of executive compensation, including management perquisites are coordinated and reasonably related.

With the Compensation Committee, the corporation can have a well practice on executive compensation.

3. 2. 2 Shareholders in Oxy to have input on executive compensation

On January 2009, Oxy has censured for the outsized pay of its chief executive, Ray R. Irani, has agreed to give shareholders a limited voice in deciding how much the Los Angeles oil company pays its top executives.

From the decision of the company's board of directors, the shareholders will have a nonbinding advisory vote on executive compensation based on the implemented "say-on-pay" policy. The new policy will go into effect at the company's 2010 during annual general meeting (AGM).

The approval of the policy by the Board made a group of corporate activists agreed to drop a say-on-pay proposal and planned to present the AGM this year. While, similar proposals received significant support at OXY's 2007 and 2008 AGM but failed to pass.

The Chief Executive Ray R Irani has been argued that the shareholders should give more power to rein in about the excessive pay.

From the research, we found that the effects of executive compensation affect the company and the entire ways of management business and also the create impact for the society.

The executive compensation plan of the organisation that design for the Executive is normally use to motivate the executive to put more effort to manage the organisation well in term of the company performances, company growth and company image.

However, the failure planning of executive compensation will cause some implied problems as which will affect the overall business operation and also to the society.

Extravagant of the remuneration package created by the board of director will contribute to “ free agent” mentality as in the organisational culture. This “ free agent” mentality will try separating the union and the cohesiveness among the top executives. It creates rivalry between the CEOs and a lack of long term commitment and vision. It shows that there is a weak correlation between the organisation performance and the executive pay package which is extravagant.

Personal gain and self-interest of CEO is normally happen in many organisations which will cause the performance and the growth of company decline. Normally, the Top executive will try to hidden the loss of the investment and business and create a false profit statements of the company account and undertake the unethical accounting methods which creating a false picture of the company profitability. The top CEO will ever do this due to ensuring the stability of his position as the top CEO and <https://assignbuster.com/definition-of-executive-compensation-business-essay/>

remaining his benefit which allow him to exaggerate or grab more personal profit in the ways that abiding the constitution and company policy.

Excessive executive compensation will cause the top executive to misuse his authority to influence and manipulate the followers to help him to do some unethical activities such as controlling the value of the organisation's stock. It shows that the conflict of interest of the top executive will create a low organisation performance and low organisational growth, besides it will also create a negative organisational culture such as a low performance norm and unethical behaviour norms inside the organisation.

From the above statements, this will impliedly affect the company shareholders and also other stakeholders. As they do know nothing whatever the top CEO is doing which had been covered up.

From the perspective of the Board, there is a threat for them if the top executives or CEOs try to manipulating the stock value and the entitle amount of the shares that the CEOs had. (For public limited company) the CEOs may hold the enormous shares if there is nothing stated for limitation of entitling the amount of share in the company policy where which will causing changing in the board, or takeover or even amalgamation of actions to another rivals (competitors of the company) as due to personal interest of the CEOs or top executives.

Instead of the shareholders benefits, the top executive had to considering the welfare of the other stakeholders such as company's employees. The bigger gaps between the welfare of the employees will indicate negative effect on the employee morale and turnover. It shows that profit sharing <https://assignbuster.com/definition-of-executive-compensation-business-essay/>

among the personnel will indicate desire solution to solve this problem. So narrow down the gaps or setting a balance and fair remuneration package among the pay of personnel and CEO will enhance the cohesiveness norms in the organisation.

In the economy point of view, as the excessive executive compensation offered, the top executive will try to retain their benefit and try to avoiding the taxes of the government. Besides, the top executive may only considering his personal interest instead of the other stakeholders. This will cause loss of economy efficiency for the community in a country.

From the studies, it shows that the executive compensation making changes in the scope of business and the society. As we can see, the rightful executive compensation package will indicate a good performance for a company, whereas unrightfully executive compensation package will create undesired problematic issues, such as ethical problems. In addition, these problems cause changes in the constitution or legislation as the ways to prevent or as a means to judge based on the acts of the top CEOs.

3. 2. 3 Advantages and Disadvantages on the OXY Human Resource Practices

There are committee known as Executive Compensation and Human Resources Committee (also call as Compensation Committee) in Occidental Petroleum Corporation. This committee was controlling and holding the job of doing research about the compensation amount, the compensation plan and writing reports for the Corporation's annual proxy statement or annual report.

This compensation committee who is in charge of all executive officers of the Corporation do reviews then approve the annual salaries, bonuses and other executive benefits of them. All the compensation of each individual in the corporation was approved by the committee. To evaluate CEO performance, the compensation committee do set an annual and long-term performance goals for the CEO, the evaluation will do with the Lead Independent Director. In the same time, make some recommendations to the Board with respect to incentive-compensation plans and equity-based plans. Besides that, compensation committee will oversee the stock-based compensation plans of the Corporation from time to time, and also make sure that the special rewards are attained only by exceptional performance.

An annual and long-term performance goal will be set by the compensation committee to the CEO to evaluate their performance. Based on this practice, we can find out that performance of the CEO is it match to their target, is it the performance of the CEO match with the amount of compensation awarded. But it brings some disadvantages. Due to the pressure by the goal, CEO may put too much of pressure to their followers, may leads to bad impression and anxiety on the followers, followers loyalty decline.

Secondly, the compensation committee will make recommendation regarding to the incentive-compensation plans and equity-based plans. There are advantages like enable to find out new and more effective ways to compensate, to motivate employees, besides, by using new incentive-compensation plans and equity-based plans employee will get updated pays, with that, could find out the most suitable plan for employee. But a fault

recommendation implement will leads to losses of corporation or dissatisfied of changes by the employees.

4. 0 Recommendation & Suggestion for executive compensation

4. 1 Recommendation of executive compensation based on disadvantage

4. 2 Suggestion for executive compensation

There are several suggestions for company wish to implement executive compensation.

First of all, the company can select an appropriate peer group for compensation benchmarking. Many companies set pay levels relative to a chosen comparator group of industry peers. The most important aspect of peer group benchmarking is to ensure the company have their peer group rights. Once they are certain of this, the practices will be very effective. In fact, the executive compensation tends to be more highly correlated with combinations of two or more company size and performance measures, such as market capitalization