

# LESSONS LEARNED

**An insight into Europe's 50 largest cap  
companies' engagement & compensation  
practice**

As companies and institutional investors have started preparations for the upcoming proxy season, a number of key points can be drawn from last year's season for an adequate preparation and effective engagement. DirectorInsight reviewed the engagement process, disclosure and pay for performance practice of Europe's 50<sup>1</sup> largest public companies, ranked by market capitalization, as a "proxy" for lessons to be learned from the 2017 proxy season.

The main lesson from the proxy season is that proactive communication can better the relationship between shareholders and the company.

**Key Findings:**

- The need for improved corporate governance and socio cultural practices, ensuring companies have sustainable and responsible practices in place, continues to be an important theme.
- Key areas of concern in corporate governance have been predominantly on executive pay and board effectiveness. Though, in addition high priority is being given to environmental and social issues as well across the globe.
- Investors are looking at the corporate governance landscape very closely and are penalizing companies and their boards for not meeting globally accepted standards. 26% of the 50 largest firms received a considerable vote (more than 10%) against the election/re-election of Board member, while another 7 companies received opposition on director re-election ranging from 5% to 9.99%. These revolts demonstrate that investors are holding directors personally accountable for failing to adhere to good corporate governance standards.
- Disclosure and transparency practice; SAP SE did not include its CEO remuneration report and practice on its AGM agenda and as a resolution item. Due to this lack of transparency shareholders voted massively against the actions of the supervisory board.
- Proactive shareholders' engagement is a great tool to avoid revolts. BP averted a repeat of their standoff with investors on their remuneration through proactive engagement this season. By their own admission, the company held several meetings with shareholders and restructured their pay policy to address such concerns. The result is that BP received 97.05% support for the remuneration report in 2017 AGM.
- Over the last years, some countries have tried to address concerns regarding excessive pay, shareholder engagement and rights by amending their Corporate Governance practices. The European Union also amended their Shareholder Rights Directive, which will become effective in 2019. However, the criticism and concerns still exists.
- The proxy season has shown that investors are not only concerned about the quantum of pay, but there are also questions about the structure, transparency and simplicity of pay policies.
- DirectorInsight's analysis shows that more than 27% of the 50 largest European companies show a misalignment between pay and performance (Total Shareholder Return<sup>2</sup>) on a one, three and a five-year basis.
- Pay structures that are not fully aligned with shareholders' interest are challenged, 26% of the 50 largest firms received 10% or more of votes cast against compensation matters and another 12% received between 5% and 10% of votes cast against their compensation report.
- The average total realised compensation of CEOs earned in the 50 largest European companies dropped by 18% against last year. The average TSR increased by 10%.

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<sup>1</sup> The selection of the companies is based on market capitalization, which is calculated from the share price at which they are trading and the total outstanding awards. The cut date is set to May 2017.

<sup>2</sup> TSR is defined here as the total return of a stock to an investor. It combines annual changes in share price (adjusted share price), dividends paid and expressed as an annualized percentage.

- The highest paid CEO in 2016 was Jean-Paul Agon of L'Oréal, who received EUR 41 million in total realized<sup>3</sup> compensation. His compensation was raised by 192%, while the TSR of the company only increased by 1% compared to 2015.
- There is only one company (GlaxoSmithKline plc) among the 50 largest firms, which is managed by a female CEO, Emma Walmsley. She did not make it to the top ten highest paid CEOs in 2016.
- As per our analysis, the companies changed the pay structure by putting less emphasis on long-term variable pay. Fixed and short-term incentive (STI) components in pay mix were increased, while long-term incentives (LTI) components were decreased.

In awarding short-term incentive, most companies used revenue as one of their performance indicators, while TSR was the most used performance indicator for the long-term incentive.




















## **AGM VOTING RESULTS**

The proxy season highlighted several very interesting cases. Europe's largest cap companies had some standoffs with their investors which did not go unnoticed. The 2017 proxy season showed that Directors from 13 companies (out of the 50) received a considerable amount of votes (more than 10%) against their election/re-election, while another 7 companies received opposition on director re-election ranging from 5% to 9.99%. Results showed that Bayer AG's Directors Wenner Wenning, Paul Achleitner, and Thomas Ebeling received 15%, 17%, and 10% votes cast against their elections respectively. Results from Reckitt Benckiser plc showed that the Directors Adrian Bellamy and Kenneth Hydon received 15% and 30% vote cast against their re-election respectively, due to the safety scandal that happened in South Korea, where their subsidiary is located. Another notable outcome was the election of Carlos Tavares by Total S.A. shareholders, where he received 19% of casted votes against. The revolt was mainly because Tavares received a lot of critique from the French government, amongst others, due to his excessive compensation for being the CEO of PSA Peugeot Citroën. The overall revolt on the election of Board members demonstrates that investors are holding directors personally accountable for failing to adhere to good corporate governance standards.

Compensation continued to catch the attention of investors in the last proxy season. Our analysis shows that 26% of the 50 largest firms received 10% or more of votes cast against compensation matters. Another 12% received less than 10% but higher than 5% of votes cast against the compensation report or the discharge of the Board in the case of non-existing compensation item on the AGM agenda. ABB Ltd. received the highest revolt with an average of 40% of the votes cast against three compensation based resolutions and 13% of the votes cast against the re-election of a Director. ABB's executive pay rose by 20% while the earnings per share fell to its lowest level since 2006. This prompted a significant number of shareholders to vote against compensation based resolutions that were put forward to shareholders. Another high revolt came from ENI SpA, which received a 20% vote cast against its long-term incentive. These revolts teach the company to design compensation structures, which reflect the long-term objectives of the company. Should the policy fail to reflect long-term sustainability goals for the company, investors are likely to revolt against such pay structures. The following table represents the companies, for which their shareholders were sceptical, regarding the compensation reports and related items.

<sup>3</sup> Pay as used in this study refers to the Total figure comprising Base Salary, Benefits, Pensions, Cash Component of Annual Incentives, and Shares that vested in the year as well as Options exercised in the year.

## Companies and revolts on compensation related resolutions

Company	Shareholder Revolt	Company	Shareholder Revolt
 ABB Ltd.	40,88%	 Nestlé S.A.	11,59%
 AstraZeneca PLC	38,83%	 Prudential plc	11,14%
 Novartis AG	10,5-36,8%	 UBS Group AG	10,50%
 Eni SpA	21,10%	 British American Tobacco p.l.c.	7,95%
 LVMH Moët Hennessy Louis Vuitton S.E.	20,99-20,91%	 Rio Tinto plc	7,35%
 Volkswagen AG	19,04%	 Shire plc	6,78%
 TOTAL S.A.	16,13%	 AXA SA	6,24%
 Anheuser-Busch InBev SA/NV	13,39%	 L'Oreal SA	5,14%
 Reckitt Benckiser Group plc	12,62%	 ASML Holding NV	5,11%
 Sanofi	12,25%		

Even though SAP SE did not make it to the list, the company received a lot of attention and critics for not including a resolution for its compensation on the agenda of its AGM. In 2016, SAP SE's executives received 180% increase in total granted<sup>4</sup> pay and 39% increase in total realized pay compared to 2015. Proxy advisors advised the shareholders to vote against the actions of its Board, as it did not address the concerns of its investors. This scenario showed a lack of transparency between the company and its shareholders. As a result, 49.51% of the total shareholders voted against the resolution on the formal approval of the acts of the Supervisory Board in the fiscal year 2016. Another interesting case is from BP. In the 2016 AGM, BP had its 2015 remuneration report defeated. Many shareholders said the remuneration policy was too complicated. Afterwards, BP was aware of what was needed to be changed in order to get the shareholders' support and to meet their expectations. The remuneration committee and the board did an extensive work. The committee chair held 68 meetings or calls and the committee met 13 times after the 2016 AGM. They restructured their remuneration policy which reflects the outcome of an intense period of engagement with shareholders after the 2016 AGM until 2017 AGM. As a result, this year, the Board secured 97.05% support for the remuneration report.

The executive compensation practices in Europe have been largely criticized over the years. For instance, companies in Germany have been long criticized for their excessive pay practice, which raises the question of engagement between these companies (who rank among the biggest in the world) and their shareholders. Even though a majority of the companies are not affected, it does tell that shareholders' rights, where these companies are domiciled, are limited. Switzerland introduced "Say on Pay" three years ago, as a measure against excessive pay. However, it is still criticized, as its executive pay packages are still among the highest in Europe. France introduced "Say on Pay" on December 9, 2016 as a measure against excessive pay. The 2017 AGM season allowed shareholders to vote for the first time on the compensation policy, while the 2018 AGM season will allow shareholders to vote on the compensation paid to directors. Both votes will be binding. The European Union has made amendments to the Shareholder Rights Directive that is expected to come into force in 2019. The amendments to the Directive include rights of shareholders to call meetings, vote on remuneration policy and approval of related party transactions by shareholders. This directive is expected to give shareholders more voice and improve the companies' engagement.

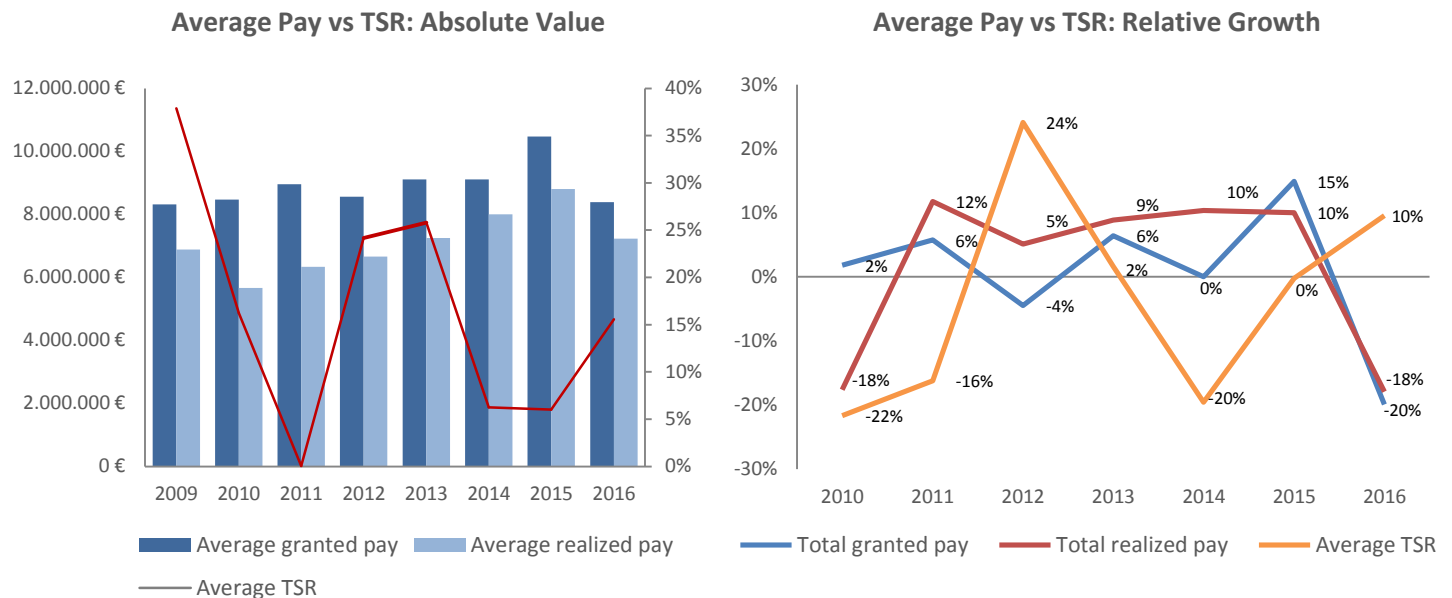
<sup>4</sup> Pay as used in this study refers to the Total figure comprising Base Salary, Benefits, Pensions, Cash Component of Annual Incentives, Shares and Options granted in the year.



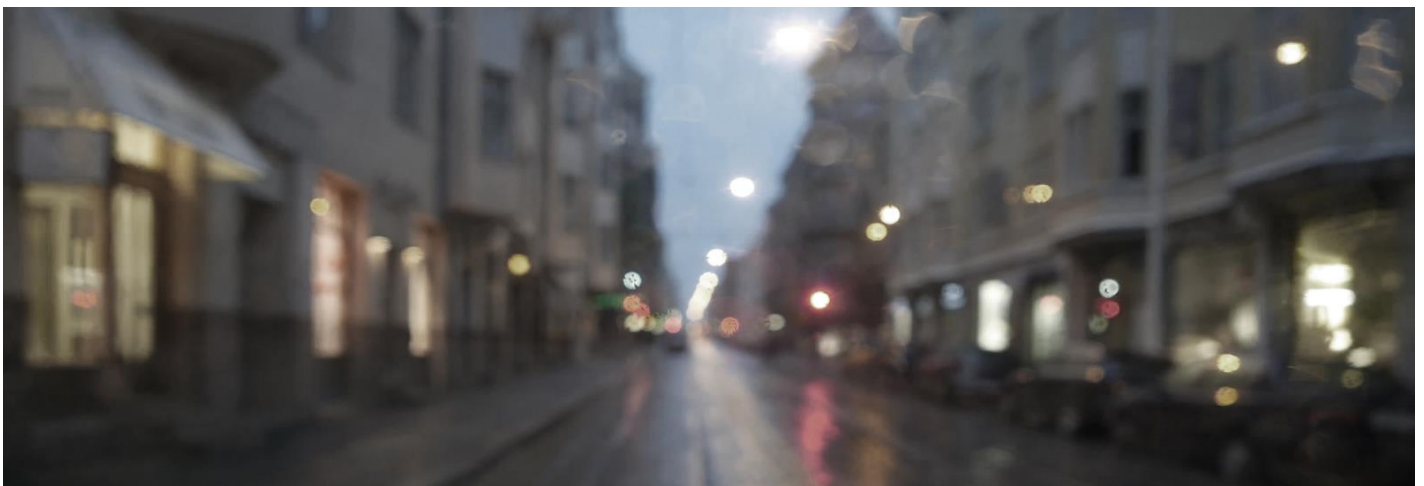


## OVERVIEW OF PAY vs. PERFORMANCE












The graph below provides insight into the average TSR growth on a year-to-year basis and the average granted and realized compensation. Average CEO compensation was stable with low volatility, while average TSR growth demonstrated a high volatility from 2009 until 2016.



The absolute value graph shows the average value of granted pay, realized pay, and TSR each year, while the relative growth graph explains the steepness of the change over the years. In general, compensation (granted and realized) shows small changes over the years when compared to the average TSR growth. The peak of the total average granted and total average realized compensation was 2015 and proceeded to decline slightly in 2016. Over the years, the TSR performance, granted and realized pay do not seem to align very well. For example, the biggest declines in the average TSR growth occurred in the periods of 2010-2011 and 2013-2014. The granted compensation in 2011, however, increased by 6% and realized compensation increased by 12%, while in 2014 the granted compensation remained on the same levels as the year 2013 and realized compensation increased by 10% compared to 2013. Based on the graph it can be concluded that both realized and granted pay are not aligned with the TSR performance.



## TOP INCOME GROWERS

Company	CEO		TRC Growth	TSR Delta	
L'Oreal SA	Jean-Paul Agon		192%	1%	▲
TOTAL S.A.	Patrick Pouyanne		67%	22%	▲
ABB Ltd.	Ulrich Spiesshofer		58%	35%	▲
British American Tobacco p.l.c.	Nicandro Durante		54%	15%	▲
Hermès International Société en commandite par actions	Axel Dumas & Henri-Louis Bauer	 	51%	18%	▲
UBS Group AG	Sergio P. Ermotti		51%	-32%	▼
Diageo plc	Ivan M. Menezes		50%	13%	▲
BNP Paribas SA	Jean-Laurent Bonnafe		49%	13%	▲
SAP SE	Bill McDermott		39%	-15%	▼
Siemens Aktiengesellschaft	Joe Kaeser		33%	36%	▲

The above table shows the CEOs, who have the highest growth in total realized compensation, when compared to 2015. The CEO of L'Oreal SA took the first position with a total realized compensation growth of 192%. His total realized pay was approximately EUR 41.2 million in 2016. The increase in TSR relative to the pay increase shows disconnect, as it only increased by 1%.

UBS Group AG and SAP SE are among the top income growers even though their TSR dropped by 32% and 15% respectively. In 2016, the CEO of UBS Group AG received total realized compensation of EUR 5.3 million and the CEO of SAP SE received total realized compensation of EUR 8.1 million. Regardless of the decline of SAP's TSR in 2016, the company still gave a positive return of 14% to the shareholders. On the other hand, UBS provided a negative return of 14% to shareholders. The increase in realized pay mainly comes from the vesting of long-term incentives, which did not use TSR as the performance indicator. In 2016, the company had lower net income compared to 2015, which was mainly due to tax benefits derived from loss carry-forwards. This could be the reason that drove the sentiment in the share price. Nevertheless, the Board of Directors was satisfied with the performance of the CEO in maintaining UBS's capital strength, which was the performance indicator of the LTI.

With regards to the other companies listed in the overview total realized pay and TSR did not increase at the same pace, which shows a weak correlation between pay and shareholders return.



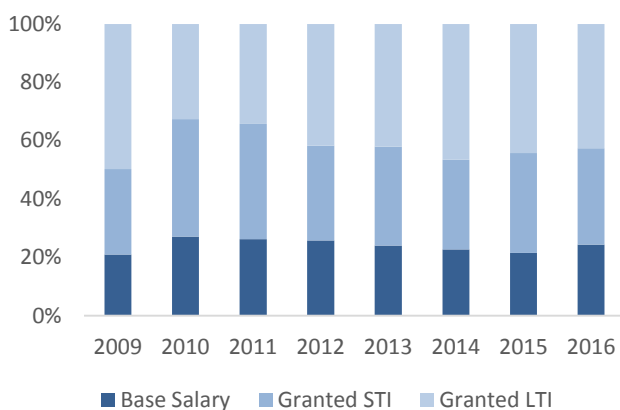


## COMPENSATION TREND FIXED vs. VARIABLE

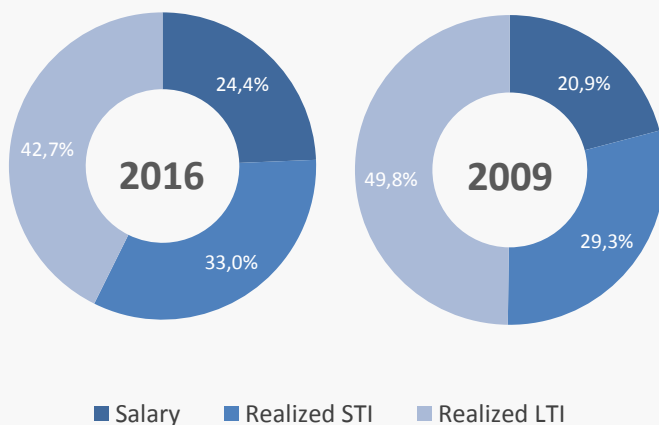
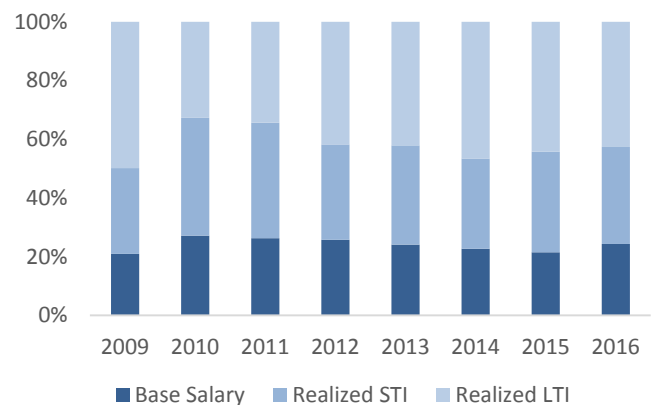
Our research shows that companies have slightly been rebalancing their CEO pay structure from 2009 to 2016. LTI remains the biggest part of a CEO's compensation; however, the quantum has slightly reduced with the base salary component slightly gaining an increase.

In 2009, base salary formed approximately 21% of average CEO realized pay among the 50 large cap companies in Europe leaving 79% of the compensation at risk. Base salary formed just 17% of average granted pay among the companies. For the financial year 2016, base salary formed 24% of average realized compensation and 20% of average granted compensation. This represents a 3% increase from 2009. The most notable trend we see here is the drop in the LTI components, in both average realized and granted compensation. LTI formed 43% and 52% of average realized and granted compensation respectively in 2016, a drop compared to the 46% and 54% in 2009. The shift from long-term to short-term incentive can also be seen from LTI/STI ratio graph. The LTI/STI ratio had a declining trend for both granted and realized pay from 2009 to 2016. In 2009, the LTI/STI ratios for granted and realized pay were 239% and 170% respectively. The ratios fluctuated throughout the years and in 2016, the LTI/STI ratios for granted and realized pay were 190% and 129% respectively.

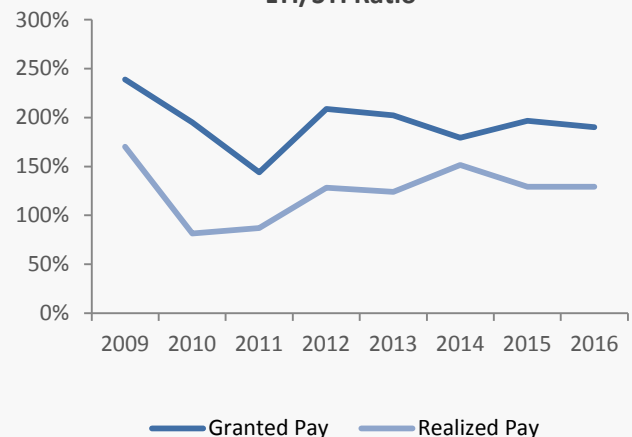
Average CEO granted pay break-down



Average CEO realized pay break-down



LTI/STI Ratio



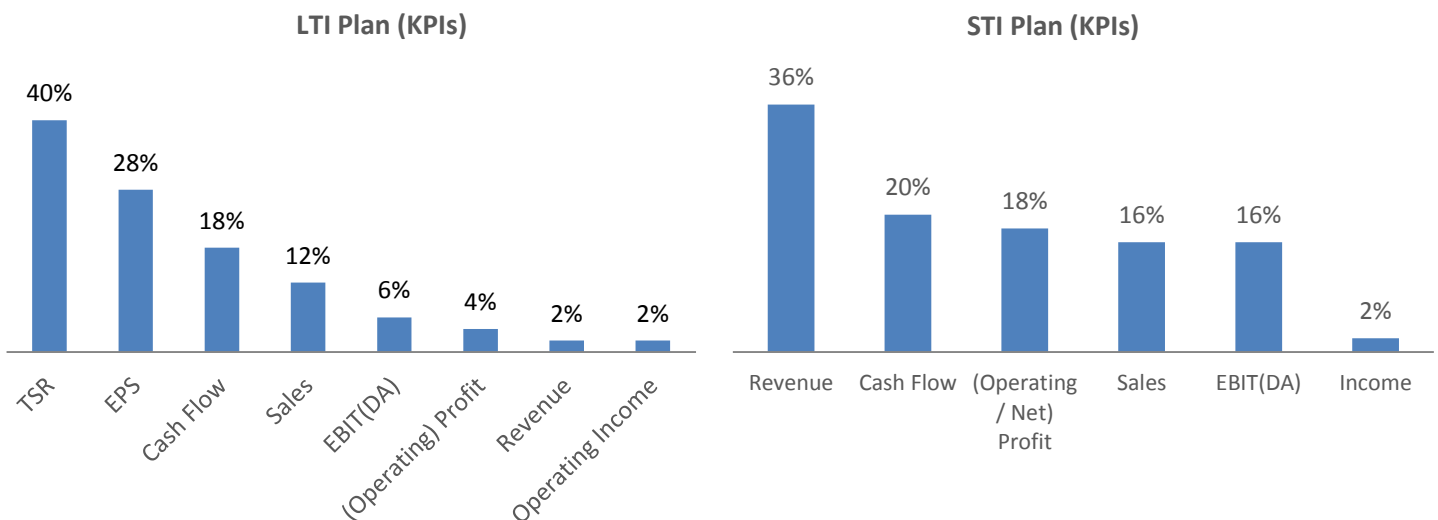


## LEADING PERFORMANCE INDICATORS

A significant portion of the CEO's compensation is tied to the variable incentive, to reward both short-term successes and sustainable long-term goals of the company. In 2016, the average variable incentive was 75.7%, which consisted for 42.7% of long-term incentive and for 33% of short-term incentive. Most of the variable incentives are driven by the company's performance, which in the event of "bad" performance will result in a significant proportion of a CEO's compensation will be at risk.

In 2016, Revenue was the number one key performance indicator when creating a short-term incentive for the CEO. 18 companies adopted Revenue as KPI for their STI plans. It is worth mentioning that 10 companies used Cash Flow as their KPI in 2016 for their STI plans.

Instead of focusing on the fundamental numbers stated in the financial statements of the company, the LTI has been mainly driven by share price. While Revenue was the #1 KPI for the STI plans, it is one of the least used when creating an LTI plan (only 1 company used revenue as its KPI). For 2016, the lead KPI for LTI plans is Total Shareholder Return, followed by Earnings per Share and Cash flow. A total of 20 companies used TSR as KPI for their LTI plans, while the other 14 companies used EPS and 9 companies used Cash Flow.





This section captures the Total Realized Pay of the CEOs of 50 largest firms in Europe ranked against their peers and their respective 2016 TSR. The pay for performance analysis conducted by DirectorInsight shows that there is still a significant misalignment between pay and performance among the 50 largest cap companies.

- On a one-year basis, 36% of the companies displayed negative misalignment
- On a three-year basis, we find a proportion of 28% displaying a negative misalignment
- On a five-year basis, 30% displayed negative misalignment.

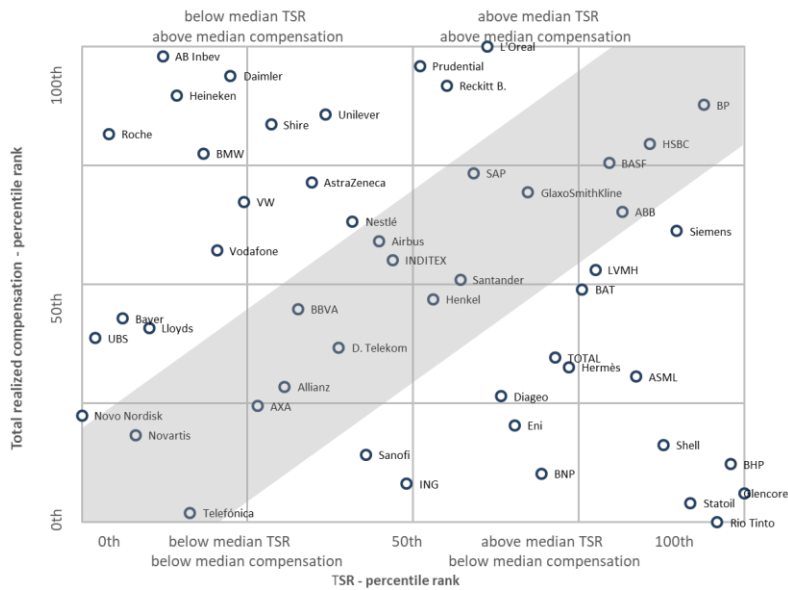
It can be noticed that over a five year period (2012-2016), compensation showed an increase, while the performance showed high volatility and a decrease resulting into a pay for performance misalignment. The highest paid CEO in 2016 is Jean-Paul Agon of L'Oréal with EUR 41 million, almost 40 times higher than the CEO of Rio Tinto Plc, Jean-Sébastien Jacques, who ranked last with only EUR 1 million. L'Oréal's 2016 TSR was at 14%, earning the company the 61st percentile position. From 2014 to 2016, Total Realised Compensation of L'Oréal CEO grew by 118% while Total Shareholder Return increased by 2%. Total CEO Realised Compensation for the three years (2014-2016) was EUR 74.2 million which ranked in the 100<sup>th</sup> percentile among the 50 companies. TSR for the period 2014 – 2016 was 43% which ranked in the 82<sup>nd</sup> percentile among the 50 companies. As displayed in the table, EUR 100 invested in L'Oréal in early 2014, will be worth EUR 143 in 2016.

The list of the top 5 paid CEOs includes the CEOs of Anheuser Busch, Prudential, Daimler, and Reckitt Benckiser, who rank 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, and 5<sup>th</sup> place, respectively. On the other hand, ING, Glencore, Statoil, Telefonica, and Rio Tinto had the 5 least paid CEOs in our current analysis with a realized compensation ranging from EUR 1 million to EUR 2.5 million. SAP, ABB, and Novartis who experienced major revolts in the current 50 largest firms list showed an alignment between pay and performance over multiple years. SAP's CEO total realized compensation was EUR 8.1 million, which ranked in the 73<sup>rd</sup> percentile in our analysis. TSR for 2016 was 14%, earning the company the 59<sup>th</sup> percentile in our analysis. ABB's CEO total realized compensation for 2016 was EUR 7.8 million, giving the company the 65<sup>th</sup> percentile, while its 2016 TSR ranked in the 82<sup>nd</sup> percentile (TSR 2016:31%). Finally, Novartis's CEO total realized compensation for 2016 ranked in the 18<sup>th</sup> percentile with a value of EUR 3.5 million. 2016. TSR, on the other hand, ranked 8<sup>th</sup> (TSR 2016: -11%). Even though the shareholders of those companies seem to be concerned about the compensation, the companies seem to have a relatively strong alignment between performance and compensation.



50 Large Cap		TYR Total realized pay (in Mln EUR )				Growth TRC Δ 2014- 2016				TSR Δ 2014- 2016				3YR sum Total realized pay (in Mln EUR )				Current value of EUR 100 investe d in 2014	
			% rank	2016 TSR	% rank		% rank		% rank		% rank		% rank	3Y TSR	% rank				
LOREAL	L'Oreal SA	41,2	100	14%	61	118%	96	2%	49	74,2	100	43%	82	143					
ANHEUSER-BUSCH	Anheuser-Busch InBev SA/NV	16,8	98	-10%	12	583%	100	-34%	7	44,7	92	40%	74	140					
PRUDENTIAL	Prudential plc	14,2	96	10%	51	-17%	33	-4%	35	44,0	90	32%	62	132					
DAIMLER	Daimler AG	13,0	94	-4%	22	10%	58	-18%	17	36,2	82	26%	47	126					
RECKITT BENCKISER	Reckitt Benckiser Group plc	11,6	92	12%	55	-50%	13	-2%	37	56,4	98	58%	92	158					
HEINEKEN	Heineken NV	11,4	90	-8%	14	112%	94	-30%	11	28,6	78	53%	88	153					
BP	BP p.l.c.	10,9	88	55%	94	-16%	35	67%	94	41,9	88	26%	53	126					
UNILEVER	Unilever N.V.	9,6	86	1%	37	14%	68	-15%	21	28,7	80	48%	86	148					
SHIRE	Shire plc	9,3	84	0%	29	58%	86	-59%	2	25,8	72	66%	100	166					
ROCHE	Roche Holding AG	9,0	82	-13%	4	-36%	19	-25%	15	49,0	96	2%	17	102					
HSBC	HSBC Holdings plc	8,6	80	32%	86	29%	76	36%	86	23,6	62	19%	39	119					
BAYER	Bayerische Motoren Werke Aktiengesellschaft	8,5	78	-6%	18	16%	72	-14%	25	24,1	66	15%	31	115					
BASF	BASF SE	8,4	76	30%	80	7%	51	36%	88	23,0	56	26%	51	126					
SAP	SAP SE	8,1	73	14%	59	-23%	27	19%	68	24,5	68	39%	72	139					
ASTRAZENECA	AstraZeneca PLC	8,1	71	0%	35	71%	88	-32%	9	23,4	60	41%	78	141					
GLAXOSMITHKLINE	GlaxoSmithKline plc	7,8	69	22%	67	11%	62	32%	82	23,7	64	15%	35	115					
VOLKSWAGEN	Volkswagen AG	7,8	67	-1%	24	-50%	15	7%	58	39,9	84	-32%	-	68					
ABB	ABB Ltd.	7,8	65	31%	82	39%	80	30%	78	18,3	39	26%	49	126					
NESTLE	Nestlé S.A.	7,8	63	1%	41	8%	53	-14%	23	22,4	53	23%	45	123					
SIEMENS	Siemens Aktiengesellschaft	7,7	61	35%	90	16%	74	37%	90	20,0	45	30%	60	130					
AIRBUS	Airbus Group SE	7,6	59	4%	45	0%	49	29%	76	27,8	74	19%	41	119					
VODAFONE	Vodafone Group Plc	7,0	57	-5%	20	88%	92	5%	56	17,4	35	-10%	13	90					
INDITEX	Industria de Diseno Textil SA	7,0	55	4%	47	-9%	41	3%	51	21,3	49	42%	80	142					
LVMH	LVMH Moët Hennessy Louis Vuitton S.E.	7,0	53	28%	78	-15%	37	15%	66	23,3	58	62%	98	162					
BANCO SANTANDER	Banco Santander, S.A.	6,1	51	13%	57	56%	84	-2%	41	16,2	29	-11%	11	89					
BRITISH AMERICAN TOBACCO	British American Tobacco p.l.c.	6,1	49	27%	76	-5%	45	14%	64	16,6	31	61%	94	161					
HENKEL	Henkel AG & Co. KGaA	6,1	47	11%	53	-21%	29	4%	53	20,0	43	40%	76	140					
BANCO BILBAO VIZCAYA ARGENTARIA	Banco Bilbao Vizcaya Argentaria, S.A.	5,8	45	0%	33	-10%	39	9%	60	46,0	94	-19%	2	81					
BAYER	Bayer AG	5,8	43	-13%	6	-6%	43	-26%	13	17,8	37	3%	19	103					
LYOYDS BANKING GROUP	Lloyds Banking Group plc	5,4	41	-10%	10	-77%	7	-7%	33	41,7	86	-16%	4	84					
UBS	UBS Group AG	5,3	39	-14%	2	131%	98	-16%	19	11,1	13	5%	21	105					
DEUTSCHE TELEKOM	Deutsche Telekom AG	5,3	37	1%	39	11%	60	-10%	31	15,6	25	45%	84	145					
TOTAL	TOTAL S.A.	5,1	35	25%	71	-20%	31	24%	74	14,5	23	27%	56	127					
HERMES	Hermès International Société en commandite	5,1	33	26%	73	74%	90	13%	62	11,4	15	55%	90	155					
ASML	ASML Holding NV	4,9	31	31%	84	-5%	47	-2%	39	15,9	27	61%	96	161					
ALLIANZ	Allianz SE	4,6	29	0%	31	-30%	25	-10%	29	20,6	47	38%	70	138					
DIAGEO	Diageo plc	4,6	27	17%	63	-68%	11	22%	72	21,9	51	15%	33	115					
AXA	AXA SA	4,2	24	0%	27	-35%	21	1%	47	25,1	70	36%	68	136					
NOVO NORDISK	Novo Nordisk A/S	3,9	22	-35%	0	8%	56	-68%	0	13,4	19	36%	66	136					
ENI	Eni SpA	3,8	20	19%	65	11%	64	31%	80	10,7	11	6%	23	106					
NOVARTIS	Novartis AG	3,5	18	-11%	8	-70%	9	-45%	4	18,6	41	15%	29	115					
ROYAL DUTCH SHELL	Royal Dutch Shell A.N.V.	3,2	16	33%	88	-85%	2	21%	70	28,6	76	21%	43	121					
SANOFI	Sanofi	3,2	14	2%	43	32%	78	0%	45	7,9	7	11%	27	111					
BHP BILLITON	BHP Billiton plc	3,1	12	76%	98	-45%	17	99%	98	13,0	17	-15%	7	85					
BNP PARIBAS	BNP Paribas SA	3,1	10	22%	69	15%	70	32%	84	8,0	9	19%	37	119					
ING	ING Groep N.V.	2,5	8	7%	49	40%	82	0%	43	6,5	4	36%	64	136					
GLENCORE	Glencore Plc	1,4	6	207%	100	14%	66	208%	100	4,1	0	-3%	15	97					
STATOIL	Statoil ASA	1,3	4	36%	92	-33%	23	41%	92	4,7	2	28%	58	128					
TELEFONICA	Telefónica, S.A.	1,2	2	-8%	16	-84%	4	-13%	27	16,6	33	-11%	9	89					
RIO TINTO	Rio Tinto plc	1,0	0	68%	96	-87%	0	77%	96	13,6	21	7%	25	107					

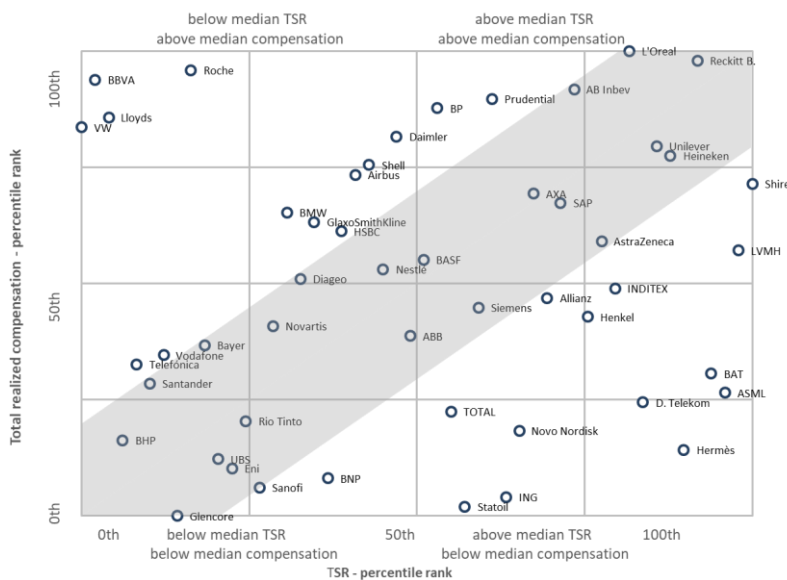
### 2016 Pay for Performance alignment CEO Total realized compensation vs Total Shareholder Return



The following charts show a company's relative degree of alignment for CEO pay and TSR performance over a 1, 3, and 5-year period, against the 50 largest cap companies that are included in this pay for performance analysis. The companies that are situated within the grey area are considered companies that have a strong alignment between pay and performance. The companies above and below the grey area, show a pay for performance misalignment at this stage.

DirectorInsight's analysis shows that approximately 36% of the total firms have a negative misalignment, 32% show a positive misalignment, while 32% shows a relative performance – compensation alignment. Negative misalignment shows that the companies have paid their CEOs relatively higher compensations when compared to the TSR (TSR ranks lower). On the other hand, positive misalignment shows that the companies are relatively conservative on the compensations paid to the CEOs while TSR ranks higher.

### 2016 3YR Pay for Performance alignment CEO Total realized compensation vs Total Shareholder Return



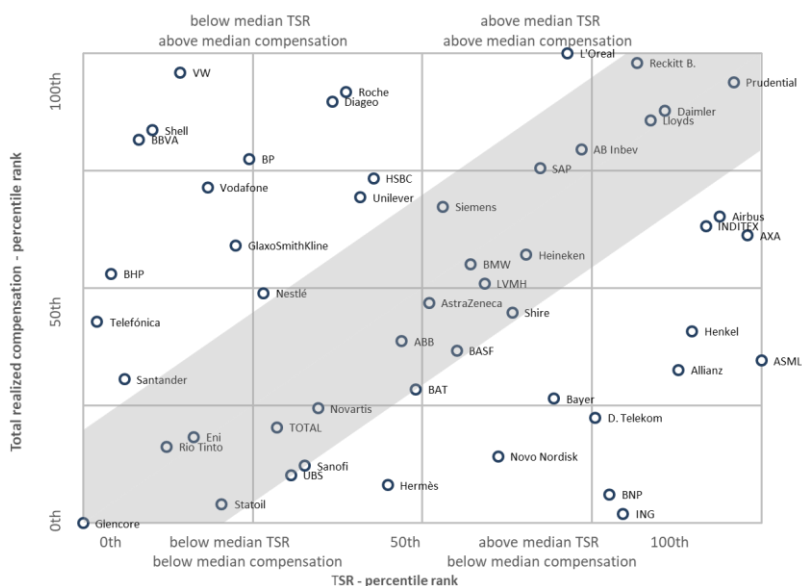
In 2016 financial year, Anheuser Busch shows the biggest negative misalignment as it ranks 2<sup>nd</sup> in terms of compensation while ranks on the 12<sup>th</sup> percentile in terms of TSR. Heineken ranks in the 90<sup>th</sup> percentile in terms of realized compensation while TSR ranks 14<sup>th</sup>.

Interestingly, ABB, Novartis and SAP which experienced revolt on compensation report and actions of the supervisory board (SAP) show a relatively strong alignment when performance is compared to compensation.

Regarding the positive misalignment, Glencore shows the biggest misalignment as it ranks in the 6<sup>th</sup> percentile in terms of compensation and 100<sup>th</sup> in terms of TSR. Rio Tinto ranks last in terms of realized compensation and 96<sup>th</sup> percentile in terms of TSR.

On a 3-year basis, the companies are shifting on a more aligned compensation policy. Aligned companies account for 44% of the total sample while the misaligned companies account for 56% of the total sample (50% positive misaligned and 50% negative misaligned).

### 2016 5YR Pay for Performance alignment CEO Total realized compensation vs Total Shareholder Return



BBVA, VW, Lloyds, and Roche are one of the most negatively misaligned companies while, ASML, Hermes, and BAT are among the most positively misaligned companies.

On a 5-year basis, the performance alignment changes again and only 46% of the total sample shows to be relatively performance aligned. The negative misaligned companies slightly increased to 30%, while the positively misaligned companies account for 24% of the total sample.

VW, Roche, BBVA remain negatively misaligned, while BP, Diageo, Shell, BP and Vodafone show a higher negative misalignment when compared to the 3-year Pay for Performance alignment analysis.

The pay and performance for LVMH and TOTAL do not show a misalignment on 5-year basis. On the other hand, companies such as Allianz, Henkel, Inditex, AXA, and BNP show higher degree of misalignment than the misalignment shown on a 3-year basis.

Evolving regulations and the recent reshape of corporate governance norms, standards and practices in European markets, along with the rising concerns on the current socio economic landscape will require companies to further demonstrate sound corporate governance practices through an effective engagement. Investors are voicing their concerns, adopting their investment strategies and through active engagement improve the corporate governance and socio cultural practices of companies they invest in. The introduction of these new rules and dynamics include companies to increase transparency, adopt a CEO Pay ratio and Pay for Performance disclosure requirement, which is expected to further increase the challenges for companies in the upcoming proxy season and shows that executive pay as a governance theme will be given high priority and will most likely experience shareholders activism when it's not perceived sustainable and aligned with shareholder interest. An adequate preparation and proactive effective engagement, through the access of powerful governance data and intelligence, will support companies, their shareholders and other stakeholders to face these challenges and improve corporate governance practices.

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## APPENDIX

### **Our methodology on total granted compensation explained**

The granted compensation includes all granted components of compensation in the year of interest. It is defined as the sum of total indirect compensation granted and total direct compensation granted for one year. It consists of base salary + benefits + other compensation + bonus + deferred cash bonus + deferred share bonus + value of performance/restricted shares granted + value of performance/restricted options granted. When the company does not disclose the average share price over the last quarter, we use the company year-end share price to calculate the value of the vested multiyear share packages. In the event there were two CEOs in a year for a company, for example, due to a change in CEO, we explored the companies on an individual basis and annualized compensations depending on the issue at hand to make the total realized compensation as realistic as possible.

### **Our methodology on total realized compensation explained**

The realized compensation includes all realized components of compensation in the year of interest. It is defined as the sum of total indirect compensation realized and total direct compensation realized for one year. It consists of base salary + benefits + other compensation + bonus + deferred cash bonus + deferred share bonus + value of performance/restricted shares vested + value of performance/restricted options exercised. When the company does not disclose the average share price over the last quarter, we use the company year-end share price to calculate the value of the vested multiyear share packages. In the event there were two CEOs in a year for a company, for example, due to a change in CEO, we explored the companies on an individual basis and annualized compensations depending on the issue at hand to make the total realized compensation as realistic as possible.

### **Total Shareholder Return (TSR)**

Total shareholder return is defined as the total return of a stock to an investor. It combines annual changes in stock price and dividends paid and are expressed as an annualized percentage. This will be calculated over one-year (1Y), three-year (3Y) and five-year (5Y) period. The growth in 3Y and 5Y TSR is calculated by the percentage points of difference between latest year and 3/5 year prior. Please note that all figures have been rounded up in the table outlining the CEO pay for performance analysis. The relative growth of TSR is the difference between current year TSR and previous year TSR.

### **Investment return of 100 EUR**

This figure looks to calculate how much a 100 EUR company investment would be worth over a period of time by indexing the TSR over multiple years.

### **Pay for Performance Analysis**

We conducted a study on CEO realised compensation to determine the degree of alignment relative to peers in the 50 largest cap firms in the European market on a 1, 3, 5 years basis. The degree of alignment is determined by subtracting the compensation rank from the performance rank within a scope of +20 or -20. Results obtained on either side determine a more generous or a conservative remuneration policy. Therefore for the three and five years' study, the percentile rank is calculated by the Total Realised Compensation over the period subtracted from the sum of the period TSR performance.