

Executive Remuneration Risks and Balanced Scorecard Solutions

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Introduction

The most important relationship in a firm is between the owner and the employees. According to the literature on corporate governance, scholars have focused on the best way to constrain the opportunistic behaviour of administrators, which is not always in the best interests of the proprietors. Executive remuneration is a potentially powerful tool by which to reduce opportunistic managerial conduct. Analysis of executive remuneration has, however, largely focused on the senior executives of large, publicly listed companies. Although many researchers examine the compensation-performance relationship in mutual companies, there is still a significant amount of research that can be conducted on publicly listed companies or governmental organisations that have not yet been studied in this context (Adams et al., 2012).

Unlike public limited companies, mutual companies do not have tradable property rights, so they face weaker market controls and, as a result, are often not governed by external market forces. Other corporate governance mechanisms therefore take on an additional vital role in attenuating managerial opportunistic behaviour. The Board of Directors, for instance, plays a vital role in monitoring the behaviour of senior executives, and in many cases, the remuneration of executives is based on the board's evaluation of their performance.

It is also important that members should be remunerated in the most appropriate way so as to serve the owners' interests by monitoring senior executives for their exceptional performances. Clearly, non-executive directors have a crucial role to play in this respect. A vital issue relates to the remuneration and incentive structures offered to non-executive administrators — such as the Chair of the Board of mutual savings and loans — as opposed to executive directors. This issue is likely to be even more significant in mutual building societies because it is not entirely clear that members' (owners') interests are best served by an objective of profit maximisation (Aureli et al., 2012).

Canyon et al. (1998) explain that there are three measures of executive remuneration, and these also aid in the removal of serial correlation. Relative productivity is incorporated as an important variable since it captures the idea that executives might be rewarded for past strong performance, and it is less prone to endogeneity issues (Canyon et al., 2000). Relative performance is only acknowledged by pay-setters after all firms' profitability is publicly available. As a result, there may be a lag in the effect of relative performance on executive remuneration. Both of these remuneration packages or approaches may differ from each other and have varying impacts, but the way in which both are used depends on the organisation and its specific policies.

Critical Analysis

In this article, Elon Musk explains the new pay deal very clearly. For many years, people have been speculating about Elon Musk's future at Tesla — whether he will be successful in the next year or whether he will step down within the next two years. He is known for his ambitious bets, but the Tesla CEO was now gambling with his own net worth. This means that for the next 10 years, he would receive nothing in the form of pay or salary. In addition, no bonus would be awarded, and no company car would be provided, as the company would need to double its market value before any compensation could be earned.

According to one analysis, executive compensation is provided in different forms — for example, salary and bonus, or even smaller packages offered by the company. Other elements such as stock options, pensions, and share plans are considered debatable because many may view them as part of the standard package, while others may not regard them as significant. These benefits are considered debatable because they help companies attract employees — particularly talented and skilled individuals — who demand these advantages. Factors such as retirement benefits and pensions also attract the attention of the media and academics. Expert criticism takes various forms; for example, critics examine the levels of pay and the organisational systems through which pay levels are determined.

This has altered the dominant research paradigm in the corporate governance field because of the variety of different criteria involved. In corporate companies or governmental agencies, there are different pay levels and different remuneration packages for executives, which are designed according to varying circumstances. Different compensation packages for senior administrators are attracting the attention of many executives and creating a powerful impact at the global level. This is motivating for those who have been disappointed by the rejection of expensive and attractive rewards, as they can be confident of receiving better rewards in the future (Conyon et al., 2000).

The article clarifies the significance of the remuneration offered by Tesla because Musk became an extremely wealthy individual who has served as Tesla's executive chairman since 2004 and as its CEO since 2008. Musk has performed well despite never accepting a salary for as long as he has been with the organisation. In fact, Musk — with an estimated net worth of \$21.5 billion — would effectively forgo his annual salary of \$56,000, the minimum wage for an 80-hour working week in Palo Alto, California, where Tesla was headquartered in 2018 and for the decade thereafter. This arrangement relates to how a well-managed and financially capable firm can address organisational challenges, and it is likely that the existing senior management of the organisation took steps to address these issues proactively (Faulconbridge et al., 2009).

In 1999, various companies granted options to their top management, and 82 per cent of those surveyed compared executive compensation packages. They concluded that the compensation and benefits provided to top management and executives are strongly effective in reducing costs. On the

other hand, it has also been argued that this approach can negatively affect the performance and motivation of executives. Rewards, benefits, and different remuneration packages are powerful factors in enhancing employee performance, including that of executives. Different research has been conducted on this issue, and most studies suggest that competitive salary packages and additional benefits are crucial factors in attracting skilled and talented individuals to organisations. These talented and skilled individuals can contribute to organisational operations and help increase overall performance. Most scholars consider that additional pay and benefits should not be viewed purely as expenses; rather, they represent an investment in the organisation to enhance employee performance. It is therefore important to use fair and transparent means when determining salaries and other benefits (Frydman et al., 2010).

After introducing the new payment plan, Musk could potentially become significantly wealthier — and so could Tesla's shareholders. To earn any compensation under the plan, Musk must grow Tesla, whose current market capitalisation stands at approximately \$59 billion, to \$100 billion in market cap. Furthermore, the increase in revenue or adjusted earnings (before interest, taxes, depreciation, and amortisation) must be no less than 70%. This would fulfil the first milestone of the 12-tier remuneration ladder, enabling Musk to exercise stock options worth an additional \$1 billion (Gerhart et al., 2014).

However, Musk also has the opportunity to collect a significantly larger windfall if Tesla's market value reaches \$650 billion by 2028. If the other financial measures increase by between 15 and 21 times, Musk could retain all 12 tranches of the stock options, netting him an additional \$55.8 billion, according to the organisation.

Musk's actual reward could be considerably greater still. After all, the CEO is also Tesla's largest individual shareholder, and if he achieves all 12 performance milestones, the organisation estimates Musk could own as much as 28.3% of Tesla. With such a substantial stake in a \$650 billion company, Musk's net worth could surge to \$184 billion in Tesla stock alone, potentially making him the wealthiest individual in the world (Thornton et al., 2012). Other literature studying remuneration has revealed that these approaches are attractive for executives and have a positive impact on organisations. However, they are also very costly for organisations, which pay substantially for these services. According to estimates, the expenses of remuneration are almost equivalent to the taxes paid (Bender, 2004).

Zajac and Westphal (2004) have proposed theories of institutional logic relating to the relationship between logic and the salary plans offered to employees. These theories illuminate the different dimensions of the relationship between the stated rules regarding remuneration and what actually occurs in practice. Corporate success lies in the fact that executive employees are experts, whereas other employees essentially act as consultants. Both are expected to act in the best interests of investors, although it is assumed that administrators are self-interested agents and that non-executive directors serve as a constraint on the opportunistic behaviour of administrators, using monitoring and incentive mechanisms to ensure that executives act in the best interests of investors.

Rules and regulations regarding remuneration packages are diverse; they are designed with the best interests of executives in mind and help organisations understand how pay packages should be structured. These rules and principles are not rigid but are clearly articulated and adaptable to the specific circumstances of each organisation.

This constitutes a broad, though not exhaustive, overview. Future research and reasoned debate among academics, practitioners, financial specialists, and regulators will be essential to determine whether existing definitions of remuneration are accurate or not. These bodies are also responsible for maintaining the rules and regulations and upholding the principles related to remuneration. For example, such rules provide guidance on whether the remuneration being provided to any executive is appropriate or not. Any revision to these principles requires a board or council to reach agreement on numerous decisions that may vary across organisations, industries, countries, and time periods (Kostiander et al., 2012).

Although the logic and principles regarding remuneration packages are generally clear, the extent to which they are applied in organisations and consistently followed remains uncertain. It is evident that earlier investigations have concentrated on executive remuneration in broad terms, rather than on the specific decisions made by remuneration committees. The notable exceptions are as follows:

Bender (2007) investigated these exceptions and identified the reasons why 12 principles regarding remuneration have been revised. In making and disclosing decisions, the remuneration committee must prioritise the remuneration principles in some manner, given that not all principles can be satisfied simultaneously. Future research should examine how different institutional logics, and the varying beliefs of directors, executives, and others, influence the prioritisation and symbolic use of these principles (Lan et al., 2010).

Conclusion

In this paper, three key ideas are explored that explain the overall picture, all of which are derived from the principles governing remuneration, the remuneration practices in use, and the processes being followed by governmental companies. Remuneration advisory groups draw upon the frameworks created through remuneration rules and packages for administrators in order to evaluate their performance, so that executives act in the best interests of investors. This collaborative approach is nuanced in that not all non-executive directors believe that financial incentives motivate administrators; rather, they seek to pay executives at a level comparable to their peers. The dominant theme underlying the remuneration process and the way it is applied is undoubtedly shaped by the diffusion of expert systems. The principles and mechanisms through which remuneration packages are determined are overseen by trustees and the board of directors, which also serves to protect executive remuneration packages from the influence of investors, the mass media, and regulatory bodies. Although a great deal of research has been conducted in this area, no single universally appropriate method of remuneration has yet been devised. The level of executives

varies across every organisation, and the structures of organisations are also quite different; a method that may be suitable for one company may not be suitable for another. Considerably more research on this topic will be needed in the future in order to develop packages that are broadly applicable to most organisations.

Question 2: Using your knowledge of balanced scorecards and organisational performance, address the following:

Discuss the risks associated with linking executive remuneration solely to financial data.

There are a number of risks associated with linking executive remuneration solely to financial data. The most significant risks are as follows:

- Incentives can become misaligned, and when motivation is low, this can cause reduced employee engagement.
- If remuneration is solely linked to financial data, it can create accounting irregularities and encourage fraudulent behaviour within the organisation.
- If the company's performance and profit are extremely high, it may not be financially feasible to pay correspondingly high incentives and rewards to executives.
- If a company rewards solely on the basis of financial performance, lower-level employees may be overlooked or undervalued.
- Risk arising from organisational culture generates considerable attention and open debate.
- Employees may be required to make an annual declaration of compliance with this requirement.
- This approach to remuneration can create conflicts among senior management.
- This process has significant potential to negatively impact organisational culture.
- The group policy does not provide for the award of any discretionary pension benefits.
- Private organisations can often offer more competitive remuneration than governmental organisations, which may create recruitment and retention challenges for the public sector.

The structuring of compensation and benefits in employment contracts can present both opportunities and risks for organisations. No single approach is universally optimal; it depends on the specific circumstances of the organisation and which remuneration method is most appropriate for its context.

Discuss how management could use a balanced scorecard to overcome these risks.

There are numerous risks associated with relying solely on financial data when constructing or linking executive remuneration packages. The balanced scorecard was developed by Robert Kaplan, a Harvard University professor, and David Norton. They began their research in 1990 across several companies, with the aim of identifying new methods of performance measurement. Historically, organisations had been relying primarily on financial measures to evaluate performance. Significant criticism emerged regarding the exclusive use of financial measures to track organisational performance (Landry et al., 2002). However, as a result of the work of Kaplan and Norton, the balanced scorecard has been developed as a tool that organisations can readily use to measure performance, or to understand the impact of risks that may arise from using financial data alone for executive remuneration. Balanced scorecards provide organisations with the opportunity to use multiple measures to assess whether the organisation is performing successfully or requires adjustment (Marin, 2017).

The balanced scorecard can be used by organisations by assigning specific numerical values to specific risks in order to understand the potential impact of those risks. The balanced scorecard gives the organisation the opportunity to mitigate risk before it actually causes a loss. In the case of risks arising from an over-reliance on financial data, the organisation can prepare itself and its employees to face the challenges ahead. It helps the organisation to be prepared for potential losses before they actually materialise (Mark et al., 2006). Financial measures typically aggregate data from all levels of the organisation into high-level financial statements. Information presented in this manner may not be particularly useful, since it often does not reach all levels of the organisation and its employees.

Question 2:

1):

$\text{Sale} = \text{Total Fixed Cost} + \text{Targeted Income} / \text{Contribution}$

$$75000 = 687500 + 1000000 / 0.45$$

$$= \$3,750,000$$

Answer cross-checked:

Sales	\$ 3,750,000.00
VC	\$ 2,062,500.00

Contribution	\$ 1,687,500.00
FC	\$ 687,500.00
Profit	\$ 1,000,000.00

2):

Total Cost	\$ 2,506.25
Direct material	\$ 1,200.00
DL	\$ 1,306.25
Overhead allocated	\$ 2,285.94

3):

	Regular Customer	Special Order
Direct material	6,500	7,000
Add: Direct labour	2,500	2,500
Add: Variable manufacturing overhead	1,500	1,500
Add: Fixed manufacturing overhead	9,500	9,500
Total	20,000	20,500
Markup	10,000	10,250

Selling price	30,000	30,750
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4):

Annuity Factor	$(1 - (1+r)^{-n}) / r$
	\$ 8.56
Cash flow	\$ 300,000.00
Cost	\$ 2,567,843.61

5):

Years	Inflow	
1	6,000	-13,000
2	8,000	-5,000
3	7,000	2,000
4	6,000	8,000
5	5,000	13,000
	32,000	

Payback Formula:

Investment required / Net annual cash flows

	0.714285714
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Payback Period	2.71 years
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6):

Years	0	1	2	3	4	5
Inflow	-19,000	6,000	8,000	7,000	6,000	5,000
Discount factor @10%	1	0.9091	0.8264	0.7513	0.6830	0.6209
NPV	(\$19,000.00)	\$5,454.55	\$6,611.57	\$5,259.20	\$4,098.08	\$3,104.61
	NPV	\$5,528.01				

7):

i):

The accountant did not follow the proper discounted cash flow techniques to evaluate the project. He apportioned the overhauling cost over the project life span rather than accounting for it in the relevant years and then discounting it. As a result, he incorrectly calculated the return of the project over the period.

ii):

Years	0	1	2	3	4	5	6	7	8
Inflows		85,000	85,000	85,000	85,000	85,000	85,000	85,000	85,000
Depreciation		-38,250	-38,250	-38,250	-38,250	-38,250	-38,250	-38,250	-38,250
Overhaul cost		0	0	0	0	-90,000	0	0	0
Net cash flows		46,750	46,750	46,750	46,750	-43,250	46,750	46,750	46,750
Investment	-320,000								

Discount Rate @15%	1	0.869565217	0.7561437	0.657516232	0.5717532	0.497176735	0.432328	0.375937	0.326902
	-320,000	40,652.17	35,349.72	30,738.88	26,729.46	-21,502.89	20,211.32	17,575.06	15,282.66
	NPV	-154,963.63							
Discount @10%	1	0.909090909	0.8264463	0.751314801	0.6830135	0.620921323	0.564474	0.513158	0.466507
	-320,000	42,500	38,636.36	35,123.97	31,930.88	-26,854.85	26,389.16	23,990.14	21,809.22
	NPV	-126,475.12							

iii):

Internal Rate of Return:

Lower rate + NPV at lower rate / (NPV at lower rate – NPV at higher rate) × (Higher rate – Lower rate)

IRR = 12%

This is lower than the company's desired rate of return of 15%.

8):

i)

Sale Budget	Oct	Nov	Dec		
Units	20,000	25,000	30,000		
Sales Price	4.50	4.50	4.50		
Total Sales	90,000	112,500	135,000	337,500	
Purchase Budget	Oct	Nov	Dec	Jan	Total of Quarter
Budgeted Sales	20,000	25,000	30,000	28,000	
Add: Desired Inventory	7,500	9,000	8,400		

Total Inventory Needs	27,500	34,000	38,400		
Less: Beginning Inventory	6,000	7,500	9,000		
	21,500	26,500	29,400		77,400

ii)

Cash Budget	Oct	Nov	Dec	
Cash of Oct	81,000			
Cash of Sep	7,200			
Payment of Aug	24,000			
Payment of Sep	24,000	24,000		
Credit for Oct sales		9,000		
Cash of Nov		101,250		
Payment of Oct		30,000	30,000	
Credit of Nov			11,250	
Cash of Dec			121,500	
Payment of Nov			37,500	
Total Cash	40,200	56,250	65,250	161,700

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