



universität  
wien

# Magisterarbeit

Titel der Magisterarbeit:

“Managerial Compensation in view of  
Corporate Governance”

Verfasser: Javlon Yuldashev

angestrebter akademischer Grad

Magister der Sozial- und Wirtschaftswissenschaften  
(Mag. rer. soc. oec.)

Wien, im März 2009

Studienkennzahl lt. Studienblatt: A 066 914

Studienrichtung lt. Studienblatt: Magisterstudium Internationale Betriebswirtschaft

Betreuer:

ao. Univ.-Prof. Dr. Franz Silbermayr

## **Eidesstattliche Erklärung**

Ich erkläre hiermit an Eides Statt, dass ich die vorliegende Arbeit selbständig und ohne Benutzung anderer als der angegebenen Hilfsmittel angefertigt habe.

Die aus fremden Quellen direkt oder indirekt übernommenen Gedanken sind als solche kenntlich gemacht.

Die Arbeit wurde bisher in gleicher oder ähnlicher Form keiner anderen Prüfungsbehörde vorgelegt und auch noch nicht veröffentlicht.

Ort, Datum

Unterschrift



universität  
wien

University of Vienna  
Faculty of Business, Economics and Statistics  
Department of International Business Administration

**Master's Thesis:**

Managerial Compensation in view of Corporate Governance

Author: Javlon Yuldashev

Supervisor: ao. Univ.-Prof. Dr. Franz Silbermayr

Vienna, March 2009

## Table of Content

<b>Abbreviations .....</b>	<b>4</b>
<b>List of Figures and Tables .....</b>	<b>5</b>
<b>1. Introduction .....</b>	<b>7</b>
<b>2. Managerial Compensations in Literature and Praxis .....</b>	<b>9</b>
2.1. Corporate Governance and Agency Problems .....	9
2.2. Components of the Compensation .....	12
2.2.1. Base Salary .....	12
2.2.2. Short Term Incentives .....	14
2.2.3. Long Term Incentives .....	16
2.2.3.1. Stock Options .....	17
2.2.3.2. Restricted Stock Plans .....	19
2.3. Criticism and Suggestions .....	20
2.4. Chapter Summary .....	22
<b>3. Transparency and Disclosure of Executive Pay.....</b>	<b>24</b>
3.1. Recent Tendencies in Disclosure Matters.....	24
3.2. Drawbacks of Transparency .....	25
3.3. Chapter Summary .....	27
<b>4. Reflections on Praxis .....</b>	<b>28</b>
4.1. Legal Background of Directors' Remuneration in Austria.....	28
4.2. Remuneration Sizes and Developments .....	28
4.2.1. Remuneration of Austrian Managers in General .....	28
4.2.2. Remuneration of ATX Managers .....	31
4.3. Discussion on the Selected ATX Companies.....	32
4.3.1. OMV AG Company Overview .....	33
4.3.2. OMV AG Managerial Remuneration Disclosure Policy .....	34
4.3.2.1. OMV AG Base Salary .....	35
4.3.2.2. OMV AG Short-Term Performance Related Compensation.....	36
4.3.2.3. OMV AG Stock Option Plans .....	39
4.3.2.4. OMV AG Other Compensation and Costs for Former Executives .....	42

4.3.1.	Erste Group Company Overview .....	43
4.3.2.	Erste Group Managerial Remuneration Disclosure Policy .....	44
4.3.2.1.	Erste Group Base Salary .....	45
4.3.2.2.	Erste Group Performance-related Compensation .....	46
4.3.2.3.	Erste Group Management Share Option Plan.....	48
4.3.2.4.	Erste Group Other Compensation and Costs for Former Executives.....	49
4.4.	Chapter Summary .....	50
<b>5.</b>	<b>Summary and Conclusions .....</b>	<b>52</b>
<b>A.</b>	<b>Appendix .....</b>	<b>56</b>
<b>B.</b>	<b>References .....</b>	<b>66</b>

## Abbreviations

---

ACCG	Austrian Code of Corporate Governance
DPS	Dividend Per Share
EBIT	Earnings Before Interest and Tax
ECGI	European Corporate Governance Institute
EPS	Earnings Per Share
EVA	Economic Value Added
FMV	Fair Market Value
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
LTIP	Long-Term Incentive Plan
MSOP	Management Share Option Plan
NOPAT	Net operating profit after tax
NPV	Net Present Value
ROACE	Return on average capital employed
ROE	Return on equity
SEC	Securities and Exchange Commission
US GAAP	United States Generally Accepted Accounting Principles
WdF	Austrian Managers Association (Wirtschaftsforum der Führungskräfte)

## List of Figures and Tables

---

Figure 2-1: Estimated average CEO compensation in 2005 worldwide.....	12
Figure 2-2: Components of a standardized annual bonus plan .....	14
Figure 2-3: Example of a multiple-goal performance bonus plan.....	15
Figure 4-1: Development of managerial compensation in Austria since 1982.....	29
Figure 4-2: Total compensation of the top managers in Austria, based on the number of employees .....	30
Figure 4-3: Total compensation of the top managers in Austria, based on total sales of the company.....	30
Figure 4-4: ATX-Top managers' average compensation growth.....	31
Figure 4-5: Top 5 directors' compensations of ATX companies in 2007 and 2006.....	32
Figure 4-6: Largest representatives of ATX .....	33
A-1: Performance of the ATX-index and selected ATX-stocks in 2005-2007 .....	56
A-2: OMV AG executives' individual remuneration in 2006-2007 .....	58
A-3: OMV AG executive board total remuneration development 2002-2007 .....	58
A-4: OMV AG executive board remuneration per member in average .....	58
A-5: OMV AG executive board remuneration components relations.....	59
A-6: OMV AG most important performance measures and ratios in 2001-2007 .....	59
A-7: OMV AG Stock options plan 2000-2007 .....	59
A-8: OMV AG Stock options granted and exercised 2000-2007 by the executives .....	60
A-9: OMV AG Stock options individual distribution to the executive board members .....	60
A-10: OMV AG stock performance relative to ATX Index in 2003-2008 .....	61
A-11: Erste Group remuneration breakdown of the 5 highest paid executives .....	61
A-12: Erste Group total remuneration of the other members of the management board.....	62
A-13: Erste Group top 5 executives' remuneration per member in average .....	62
A-14: Erste Group top 5 executives' remuneration component weights .....	62
A-15: Erste Group payments to former members of the management board.....	63

A-16: Erste Group key ratios: ROE and dividend payout ratio.....	63
A-17: Erste Group most important performance measures and ratios in 2003-2007.....	63
A-18: Erste Group ownership structure .....	64
A-19: Ownership of the shares by the top five highest ranked board members .....	64
A-20: Erste Group stock performance compared with ATX Index in 1999-2008.....	65



## 1. Introduction

---

In the last few decades corporate governance has become one of the most widely discussed topics in the modern business life. A number of surveys have been published in this area, revealing various aspects of corporate governance. Different approaches were used and authors came up with various interesting outcomes.

One of the crucial questions has been and stays executive pay. How much do managers get paid for their work? What internal and external factors do mainly influence compensation? What are the components of compensation and how are these determined? These are few of many questions on managerial compensation issues, which arouse interest of researchers, as well as a society in general.

If managerial compensation has been already a subject of many extensive surveys in Anglo-Saxon countries, for example (Murphy, 1999) and (Guay, Core and Larcker, 2002), the situation in Germany and Austria still reveals a big gap. In some extent, this can be explained by generally older and more mature corporate governance regulation systems of North America and Great Britain compared to Western Europe. Besides, such tendency is also induced by the fact, that Anglo-American companies publish much more detailed information on executive pay than in the rest of the world. Annual reports or proxy statements include a separate remuneration part, precisely describing how much every single manager gets paid. And this is not the case for German or Austrian companies yet, at least for the majority of them.

There has been much criticism of European society on the sizes of managerial compensations and benefits, intensified since the financial crisis 2007, when managers of big banks and companies continued receiving high compensations in spite of economic downturn. Lots of debates are taking place on national, as well as EU level underpinned by political and social considerations. Legislators are thinking about a law mechanism, regulating limits for the maximal allowed compensation size. Another consideration is the setting of a cap, excess of which should be defined as unreasonable and therefore should be non tax deductible on corporate level.

All these debates are induced, as I already mentioned, by political and social reasoning. Politicians usually do not try to understand economical bias of managerial payment. Their only motivation is a substantial cutback of “asocial” and “unreasonable” sizes of compensations, without in-depth analysis of the problem.

From my point of view it is rather important to understand intrinsic and extrinsic motivations driving executive pay. Doing this one should take a sober view of the problem and do not let

emotions interfere objective economic judgment. At this point, it is important to mention, that the average size of overall managerial compensation is still substantially smaller in Europe-based companies compared to companies based in the US. With this work I will attempt to discuss and assess executive pay characteristics in Europe, particularly in Austria.

My thesis will be structured as following. First, I will begin with a description of theoretical principles of corporate governance setting emphasis on executive pay. For this I will give a short overview of the existing literature and surveys from the past, discussing origins, main results and conclusions of the remuneration problems. This will also include widely used components of the compensation, with considerations on positive and negative impact on the managerial performance.

In the next part I will give an overview on transparency and disclosure matters. Discussion on positive effects of increased transparency, as well as on recent tendencies in the major world economies will be followed by some thoughts on possible drawbacks, hidden behind increased transparency.

After such a mostly theoretical overview I will continue with remuneration-related reflections in praxis. Doing this I would like to focus on the situation in Austria. This is very challenging, since there are no comprehensive empirical studies available yet, which analyze in detail CEO-pay in German-speaking countries. This lack occurs mainly due to disclosure regulations in these countries.

The target of my thesis will be to make an attempt to describe an optimal compensation strategy, which can be successfully applied by publicly listed companies. I will try to determine a general framework for compensation assessment in evaluating the reasonableness of each single component of the compensation: base salary, variable bonuses, and long term incentives. For this I will use considerations from the theoretical part of my thesis, as well as results from existing surveys and information from annual reports of selected firms.

## 2. Managerial Compensations in Literature and Praxis

---

As Murphy points out, there has been a lot of research on CEO pay, beginning with pioneering works of Roberts (1956), Baumol (1959), and Lewellen and Huntsman (1970) (Murphy, 1999). If we dig deeper into the origins of the issue, we can observe that the executive compensation problem is closely related to the agency problem issue, which was already addressed by Adam Smith in 1776: *“The directors of such (joint stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.”* (Smith, 1776, P. N/A)

In other words, the ownership separation and appointment of professional directors, who actually do not bear the same risk, which investors usually do, prescribes interest differences between managers and stakeholders, particularly shareholders. And that is the basic prerequisite for becoming the field of corporate governance so important in the modern corporate form of organization. Denis summarizes that in the last 30-35 years there has been done much research work about the corporate governance and now it represents an integral part of modern corporations; however, almost every research paper concerning corporate governance cites the above mentioned statement of Adam Smith from 1776, who can be truly considered to be a pioneer to describe ownership separation problem (Denis, 2001). Of course, the elements of corporate governance existed and were implemented long before researchers actually began using the terminology of “corporate governance” as it is known today, but in the last few decades corporate governance was shaped and developed to a large extent, so that more or less clear constraints and understanding became generally accepted.

So what is actually corporate governance and how it is related to executive compensation in context of agency problems?

### 2.1. Corporate Governance and Agency Problems

Though corporate governance has been widely discussed and recognized, there is no generally accepted definition for it. Considering various views and approaches it can be summed up that corporate governance comprises a set of internal and external elements and mechanisms, which are applied to direct, manage, monitor and control the corporation taking into consideration interests of entirety of stakeholders (with major focus on shareholders), as well as society as a whole. The initial role of the corporate governance was expanded and regulations were reconsidered in the course of a number of collapses of large US corporations

in the early 2000s (Enron, Worldcom), when poor corporate governance systems of these companies were held responsible for such an outcome in the first place. It is also obvious, that the devastating implications of the ongoing crisis 2007-2008 will have also major impact on corporate governance mechanisms within separate companies, as well as on corresponding legislation of affected countries.

Generally, individual corporate governance mechanisms may be structured in the following four basic categories (Denis, 2001, Jensen, 1993):

1. Country's legal system implied in the legal and regulatory mechanisms.
2. Internal control mechanisms of the corporation:
  - General meeting of shareholders
  - Supervisory board and/or board of directors
  - Large shareholders, blockholders
  - Debtholders or creditors
  - Executive compensation
3. External control mechanisms.
4. Product market competition.

One of the central and initial objectives of the corporate governance is to minimize agent-principal problem or agency problems. This objective remains central also nowadays, however with some reconsidered approach. Thus, I will give a short overview of agency problem, as it was characterized originally.

The agency problem is a conflict of interests between the Principal (owners) and the Agent (managers). Jensen and Meckling in their "Theory of the Firm" provided comprehensive explanation on some important aspects of how and why such conflicts may occur. According to their model, if the same person owns and runs a company, he is much interested in keeping his company as valuable as he can. Thus, such owning-manager is highly motivated and committed to give his best for his own company, without enjoying too much "fringe" benefits or using "perks". Spending of corporate money for such non-pecuniary benefits would mean wasting the manager's own money, as he is holding 100% of the company's equity.

If manager owns everything less than 100% of the company, his attitude would be different, i.e. for enjoying of 100% of non-pecuniary benefits his stake would be less than 100%, namely as high as his share in the company. (Jensen and Meckling, 1976)

There are also many other points, when shareholders' interests and interests of managers collide. For example, Denis points out three basic sources of such conflicts (Denis, 2001):

- Managers' desire to remain in power
- Managerial risk aversion (different risk perception by managers and shareholders)
- Free cash flow (excess cash flow left, when investments in all positive NPV projects are exhausted. Shareholders would prefer payout of such cash, but managers may continue investing also in negative NPV projects, increasing sales and sizes of the company)

Aggregated, these conflicts represent agency problems and cause agency costs, which in the end bear shareholders.

There are some widely accepted solutions to the principal-agent problem in frame of corporate governance. One of the approaches prescribes high levels of monitoring of managerial behavior by effective and credible monitors, who may represent a real threat to the managers when they act against shareholders' interests. But this approach is connected with high costs and is not always effective: bad managerial decisions may lead to a poor outcome, but also good decisions may result in a bad outcome due to the external factors, beyond managers' control. Hence, the good monitor should perceive the difference, what is usually a very complex and difficult task to fulfill.

One of the crucial, maybe the most effective, methods of reducing agency costs is a well designed incentive contract in frame of the internal control mechanisms of corporate governance listed above, which brings managers' interests into line with the interests of shareholders. If one manages to design an optimal incentive contract, which is perfect, the agency problem would become obsolete. This, of course, is a utopian way of solving the problem, as it is not possible to create a perfect contract, which includes all possible managerial decisions for every possible situation, which manager may face. Besides, if shareholders knew the best way of doing business, why would they need anyone like a manager at all?

Hence, a good management contract should stimulate managers to commit themselves to work as hard as they can and to take the best possible decisions in the interests of shareholders, i.e. creating value for shareholders. There are a lot of different approaches, on which base compensation should be calculated. In different countries, depending on industries, one can observe various pay practices. An overview of the most important components of executive pay is given in the following chapters.

## 2.2. Components of the Compensation

In general, modern managerial contracts all over the world include a fixed (base salary) part and a variable (incentives) part of compensation. The variable part, in its turn, may include various performance based remuneration systems such as accounting performance based bonuses, stock options, long term bonuses and stock plans. Executives often also receive additional utilities in form of non-pecuniary benefits and perquisites. Such fringe-benefits are non-wage compensation paid out in addition to the base salary and are not directly connected to managerial performance.

In Figure 2-1 we can observe the relation of variable part of compensation to its fixed part in different countries.

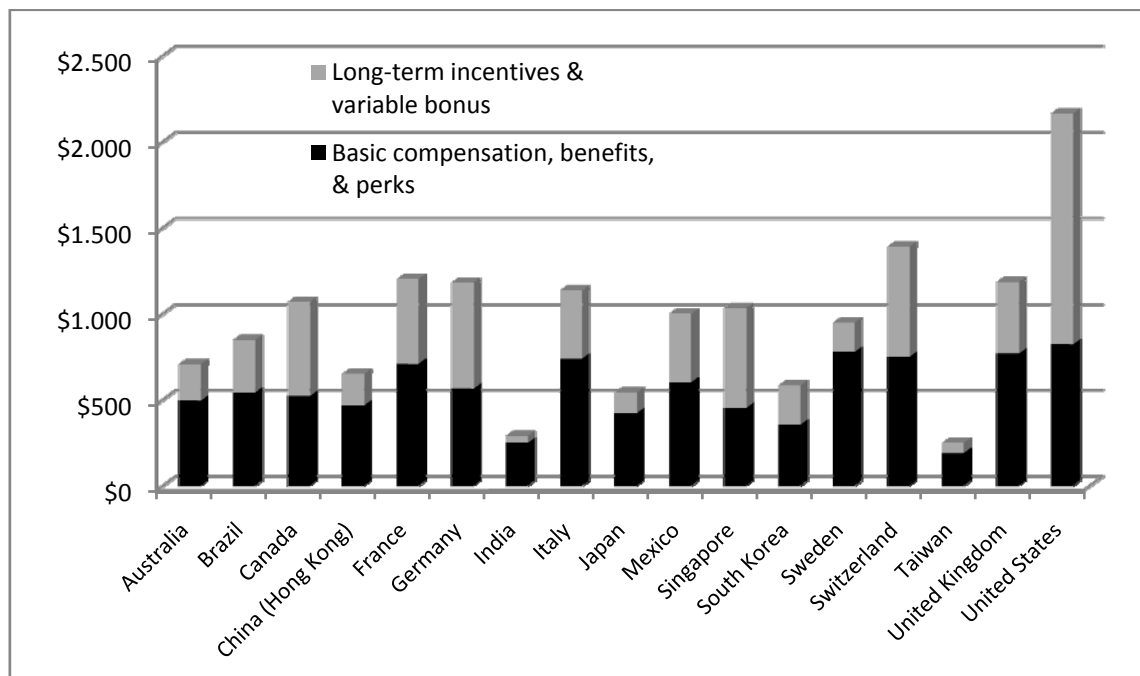


Figure 2-1: Estimated average CEO compensation in 2005 for companies with at least \$500 million in sales worldwide. Long-term incentives include grants of stock and stock options. Source: Towers Perrin, 2005-2006 (Brealey, Myers and Allen, 2008, P. 332)

As we can see, the size of the base salary and incentives may vary widely from country to country. Further, I will try to summarize the theoretical background for every component of compensation.

### 2.2.1. Base Salary

The base salary of the manager is an annual wage, which is fixed by a contract in beforehand and paid in full without consideration of performance as long as manager stays within the company. According to Bruce Ellig *“the amount of salary an executive is paid is a function of*

*the value of the individual's responsibilities to the organization and how well the individual is discharging these responsibilities"* (Ellig, 2007, P. 167). The base salary is influenced by many factors, such as, for example:

- Size of the company
- Managerial position and responsibilities
- Overall performance assessment
- Professional experience
- Experience (number of years) within the company
- Value and availability of comparable managers in the market
- Regional and social aspects
- Legislation and taxation considerations

All in all, the salary is based on complex evaluations and benchmarks, which are well known and more or less standardized in different parts of the world. One important distinguishing feature of the US tax legislation is the "Million Dollar Cap", in power since 1994 (Rose and Wolfram, 2000). This cap prohibits tax deductions on corporate level for compensations for the five highest ranked managers of the company, when single compensations exceed 1 million US dollars. However, performance-based compensations are excluded and are still tax deductible. May be that is why we can observe such considerable overweight of variable incentives over base salary in the USA in comparison to other countries. Also in Europe there are some debates on this issue, but there is no consistency and mutual agreement yet (Tagesspiegel, 28 April 2008).

In recent times, the base salary is becoming the smaller part of total compensation; however the importance of salary is not influenced by this fact. Murphy points out key issues, why managers are still very anxious in negotiating their own base salary and its growth perspectives. Mainly, base salaries represent a key component of executive employment contracts and are fixed in advance. Hence, risk-averse executives would prefer increase in base salary rather than bonus or any other variable compensation of the same amount. Another important aspect pointed out by Murphy is that most of the other components of compensation package are usually measured based on base salary size (bonuses as a percentage of base salary, options as multiples of base salary, as well as pensions and golden handshakes also relative to base salary). All in all, an increase of base salary leads to an increase of the whole compensation and benefits package (Murphy, 1999, P. 9-10). In addition, once fix salary is increased it will be probably never be reduced again, whereas this is not true when considering variable bonuses.

### 2.2.2. Short Term Incentives

Short term incentives are typically annual bonus-plans, which are used to measure yearly performance and corresponding bonus-compensation, based on present annual performance standards and goals.

A standardized annual bonus plan is illustrated in Figure 2-2. Such a plan prescribes setting target performance with appropriate target bonus size. Usually, no bonus is paid until the threshold performance is achieved. Once maximum performance level is succeeded, the bonus is capped. Such plans are also called 80/120 plans, meaning no bonus is paid until 80% of target performance is achieved and bonus is capped when 120% of target performance is achieved. Bonus levels may also vary widely. Usually 10-20% of target bonus is paid on achieving the threshold level and capped by 150-200% of the target bonus size.

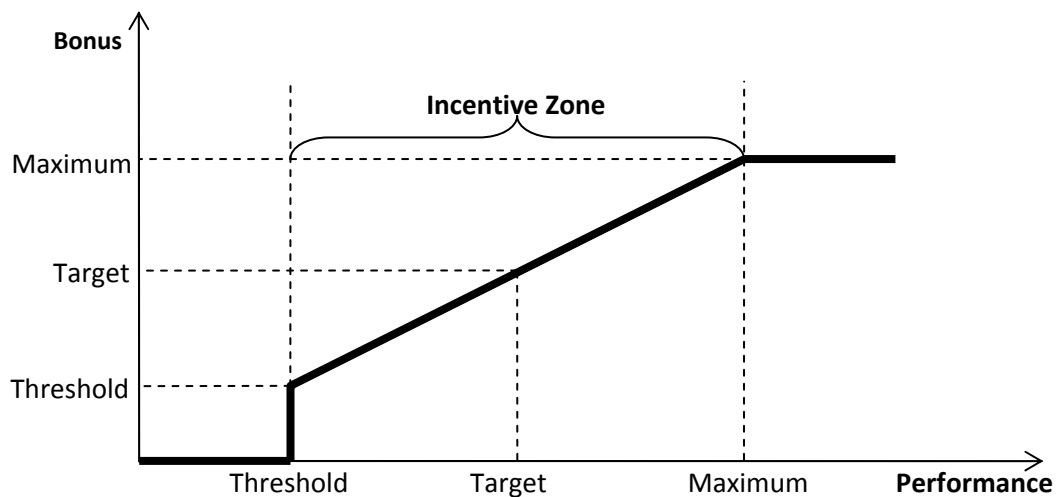


Figure 2-2: Components of a standardized annual bonus plan

Performance evaluation may be done by means of financial and non-financial performance measures, depending on industry-specific features and focus. Financial measures may comprise accounting profits, such as revenues, net income, pre-tax income, operating profits (EBIT), or economic value added (EVA). Non-financial measures include “individual performance”, based on subjective and objective assessments, customer satisfaction, implementation of some strategic or operative plan by given deadlines, safety improvements etc. While financial services are less likely to use non-financial measures, industrial firms and utilities more often implement non-financial measures.

There are different approaches also in using these performance measures. Annual bonus may consist of a single-measure approach, as well as of a multiple-goal bonus plan. An example for a bonus plan consisting of two performance measures is given in Figure 2-3. If target



performance is achieved for objective B, but for objective A only threshold performance, this would imply in 20% bonus payout.

Objective A Performance	Objective B Performance		
	Threshold	Target	Maximum
Maximum	100%	150%	200%
Target	60%	100%	150%
Threshold	10%	20%	100%

*Figure 2-3: Example of a multiple-goal performance bonus plan*

*Source: (Ellig, 2007, P. 352)*

Such and similar annual bonus plans represent a good incentive and make sense only in appropriate cases and if used carefully, considering possible implications on long term performance. Most important drawbacks are comprised below.

Too high incentive to maximize current compensation, based on annual performance measures may cause shifting money from highly valuable long term R&D investments to other spheres, thus increasing short term performance values and harming long term company objectives.

Another problematic issue of above-mentioned 80/120 plan based on annual accounting profits is that managers may try to manipulate these accounting results, particularly in the following cases:

- If it becomes clear, that 80% threshold performance is rather impossible to achieve, managers may try to reduce accounting profits even further and shift earnings partially in the next period. Reduced performance would also mean reduced performance standards for the following periods, making it easier to succeed in achieving decreased target performance.
- Similar manipulations may occur, if it becomes clear, that 120% (maximum) performance will be exceeded. There will be either no incentive to continue working hard further or incentive to hide earnings partially to use them in the following periods as in previous case. Moreover, there is even an incentive to reduce performance in order not to be punished by higher performance standards and targets in the following year.

In order to avoid such problems, it is proposed by some authors to use so called “bonus banks”, which may increase or decrease in annual terms depending on performance and target bonus. The annual payout would be then the target bonus plus some fraction of the remaining amount in the bonus bank, but in total not exceeding the bonus bank. The bonus bank may also become negative. This means, that poor performance would impact the bonus of the following period(s) and there would be always incentive for managers to achieve good

performance, even if maximum performance is already reached, or if the threshold performance may not be reached in the current year.

Also the question, which performance measures should be used for bonus plans is very important. Inappropriate measures may work overall counterproductive. In fact, maximization of, for example, EPS would mean that every investment in projects, generating positive returns would count, even if these projects have negative NPV.

In setting performance standards, many authors suggest using externally determined standards, rather than internally determined ones. This means it is more important to compare own performance with the performance of appropriate peer companies or peer divisions, rather than just awarding managers of profitable divisions and disregarding managers of problematic ones. If there is lack of incentives in problem divisions, highly qualified managers would have serious motivation difficulties to be transferred from profitable into problematic division (Ellig, 2007, Murphy, 1999).

But still, these plans should not be too complicated and must be well communicated, so that managers really do understand their incentives-structure and believe that only superior performance will be awarded with high payout and bad performance will be punished, without any changes at discretion of responsible board or committee members. Transparency and credibility of bonus plans are the key factors of success. Whereas even very smartly designed short-term incentive plans may do harm the company in the long run. In order to cut such drawbacks, many corporations combine annual bonuses with long term incentives.

### **2.2.3. Long Term Incentives**

As mentioned above, in addition to annual bonus plans many companies use long term incentives, which reward managers for long-term success. Usually such plans consist of midterm (three to five years) and long term (more than five years) incentives. But there is no grave difference between these categories aside from the length of performance period, so speaking about long-term incentives I would like to address also the midterm incentives-category.

In the literature we can find incentive plans based on stock options, restricted stock, LTIPs, stock appreciation rights and many various combinations of these and other equity alternatives. Over the last years, stock options have been representing the most important type of long-term incentives, amounting to the major part of total compensation in many cases. At the same time, more and more criticism occurred in media, as well as in academic research, so that restricted stock become more popular and eventually started to replace stock

options. Due to the limited constraints of my thesis, I would like to cover only the most important long term incentives used by publicly listed companies, namely stock options and restricted stock.

### **2.2.3.1. Stock Options**

A stock option is a call option for a predefined amount of shares, i.e. it gives right to managers to buy company's stock at a strike price (usually grant date price) after the expiration of some fixed period of time (vesting period). The underlying idea was that stock options would help to align managers' interests with interests of shareholders, as managers would be motivated to impact their own payouts by taking measures towards increasing share price.

A typical vesting period of stock options is 10 years. Options may be exercised only if the executive stays within the company over the vesting period, otherwise the options become worthless. There are different ways of setting the exercise price. The most common one in praxis sets the exercise price equal to the Fair Market Value on the grant date. Other possibilities would be discount options with exercise price below FMV or premium options with exercise price above FMV.

Since standard options do not carry any intrinsic value on the grant date (at the money option), it is difficult to determine the real value of such options. In literature one may find two possible indications on options pricing:

- value, which manager gets in the current year by exercising options granted in previous years
- value of granted options in the current year, estimated using some pricing model, most commonly Black-Scholes-Model (alternatives would be binominal model, monte-carlo-simulations and many others)

The problem of including the exercised options in the total compensation of the current year is that exercised options do not relate to current or future performance, but rather to previous years. Hence, it would not be very rational to consider them as a part of current year compensation. Another problem occurs, when valuation is done using Black-Scholes, as this model does not consider dividend payouts and vesting periods of the stock options, hence options are usually highly overpriced. Additional adjustments could solve this problem in some extent, but these are complicated and not commonly standardized.

Speaking about stock options as an incentive, it is important to point out, that stock options represent an incentive form, which is not directly tied to any goals. Market fluctuations may

make stock options extremely valuable or completely worthless. The motivating factor stays alive as long as the market price stays above exercise price. If the stock prices drop and there is little chance to catch up with the stock price of the grant date, stock options lose their motivating power and may even serve as an incentive for managers to cause further stock price drop in order to receive their next stock options with the minimal exercise price possible.

Many authors also point out the importance of understanding that the costs born by shareholders from granting stock options are higher than the value perceived by option receivers - managers. Hence, stock options should be granted if and only if the increased managerial performance may cover arising difference between shareholders' loss and managers' perceived gain; this, however, is very difficult to determine, especially in advance. The plausibility of value differences is clear: any exercised option dilutes stock and transfers value from existing shareholders to the new owner, causing 100% loss of this amount for old shareholders. On the other hand, when receiving these options, there is no intrinsic value for managers, so they value options accordingly.

Moreover, perceived value from getting stock options is directly correlated with stock fluctuations; hence, maximization of personal value means for executives investing more risky and reaching higher levels of stock-price volatility. For example, let's consider two possible projects, A and B. Project A has outcome of +125 or +75 with equal probabilities. Project B has outcome of +300 or -200 also with equal probabilities. Thus, shareholders would prefer Project A, since the NPV of the Project A is 100 and NPV of the Project B is only 50. But managers, having only limited risk (in the worst case payout would be zero) would prefer the Project B:  $\alpha 100$  against  $\alpha 150$ . If, for example,  $\alpha$  equals to 10%, preference of Project B would cause value reduction of shareholders by 50 (NPV of 50, instead of 100), and value of stock option for holding managers would increase by 5 (15 instead of 10).

Another drawback arising from stock options grants is the reluctance of managers holding stock options to pay out dividends, as dividends cause stock price drop. On the contrary, stock repurchases may be pushed by managers holding stock options.

As I already mentioned, stock options become worthless, when the stock price drops significantly below the exercise price, thus losing their incentive value. Often this leads to option repricings with justification that the lost incentive value has to be reactivated. But, the very fact of the admission of such repricing-possibility at board's discretion may completely destroy the idea of stock options as an incentive factor already in advance.

Murphy observed that "during the early 1990s, stock options replaced base salaries as the single largest component of compensation (in all sectors except utilities). Option grants in

manufacturing firms swelled .... more than doubling in dollar terms". This observation is very interesting as a \$1 million dollar cap for non performance related compensation was introduced in USA also in the early 1990s (Murphy, 1999, P. 6, 52). Hence, taxation considerations could have played the major role for stock options boom and relative compensation shift from base salary towards stock options; and not due to the "official version" of incentives. Nevertheless, a discussion on possible impacts of taxation issues lies beyond the constraints of my thesis; therefore I would like to restrict myself to incentive based motivations of stock options specified above, representing one of the important levers of the corporate governance.

At the same time, all the problems with stock options described above, as well as vast public criticism of huge payouts of sometimes hundreds of millions of dollars, earned by executives through exercising options from previous years, lead many corporations to change from stock options to restricted stock plans.

#### **2.2.3.2. Restricted Stock Plans**

A restricted stock plan presumes free stock awards to executives, which goes to the managers' belongings only after these are released or vested; thus they are called "restricted" (Armstrong and Murlis, 2007, P. 324). The amount of the granted stock depends on performance targets, which are usually fixed in advance and set for 3 or 5 years. After restricted stock is granted there is usually also a holding period, when no further performance is required, but managers should stay within the company for a specified period of time and are not allowed to sell shares. Like stock options, restricted stock should help to align managers' interests with interests of shareholders, as managers would become stock owners; some speak about restricted stock as a stock option with exercise price equal zero. Still, there are various advantages of restricted stock compared to stock options, which maybe mainly derived from drawbacks of stock options.

First of all, restricted stock plans are easy to understand and are transparent for recipients. Being effectively a stock, and not an option to buy a stock, restricted stock is more likely to be perceived as a real participation on the equity of the company and not like a gamble-perception in the case of stock options. Also downside risk is shared with shareholders and managers have still incentives to increase stock price even in very difficult circumstances, e.g. when stock price dropped significantly and grant-date price is perhaps impossible to achieve. In case of stock options, holders would lose the whole amount, whereas restricted stock has reduced but still existing intrinsic value. If market drops, no repricing is necessary and the

incentive factor for good performing managers is still there; they just lose part of the income, like usual shareholders do.

Closer alignment with interests of existing shareholders is also given by the absence of the managerial willingness to reduce dividends, since restricted stock holders also receive dividends.

### 2.3. Criticism and Suggestions

As already mentioned in the beginning of the chapter, there has been done a lot of research work on corporate governance and the agency problem implications have been widely discussed. However, when considering executive compensation, there is still no consensus among the authors. It is also not possible to find out, what sizes of compensation may be classified as reasonable and appropriate in general.

Concerning separate compensation components I have following remarks and suggestions:

**Base salary.** From my point of view, the most appropriate way to determine the right size of the base salary of the top executives is benchmarking and evaluations. One should analyze the commonly used salaries for managers with similar qualifications and similar range of responsibilities on the same market and derive appropriate salary for the given manager on that basis. One of the most important factors in determining appropriate salary amount of the top executives is the firm size, measured by total sales and the average number of employees. However, this should not become an incentive for managers to increase the company sizes by all means, endangering sustainability and profitability. Hence, from my perspective, once base salary is set, it may be increased or reduced for the subsequent period according to the previous achievements of the manager and the state of the company, but firm size should not directly influence the salary size any longer. Changes in company size should be rather considered as a subsequent consequence to other actions, but not as target itself.

The possibilities of salary reduction should be also provided by the contract (in case of a bad performance of the manager or bad economic situation and consequently bad health of the company). However, the intentions of the legislator to set a general limits for the executive compensation I consider for non appropriate and against the principles of the free market economy. Also the one million dollar cap, set for the base salary in the U.S., did not impacted the total compensation of the executives on a large scale, but just shifted a part of their salary to the bonus and stock based compensation part. From the other hand, I think it was a reasonable proposition made by the U.S. President Obama to limit managers' base salary by \$ 500.000 and to prohibit all bonuses paid to them, if the company was in trouble and had to

participate in the bailout program of the U.S. government in order to assure its existence (NewsDaily, 04 February 2009). This will motivate managers to improve the situation and to seek for the ways of making their company competitive and profitable again in the shortest possible period of time in order to pay tax-payers money back in form of the governmental supporting loans. However, I am not entitled to judge the appropriateness of the size of such a limit.

**Short term incentives.** Annual bonuses are also widely discussed and explained. However, from my perspective, there is not enough attention given to comparative methods of determining such bonuses. Majority of authors rather discuss which measures are reasonable and appropriate to be implemented for this or that company, as well as how these measures can be applied to those companies. Also bonus banks are considered to be a good incentive for achieving a steady growth over several years, in order not to harm long term performance.

But, external factors are also very important and should be involved in short term incentive considerations. Market conditions, economical and political situation, actions and performance of the competitors are few of many external factors, which are very important in evaluating the managerial performance on annual basis. Usually, when there is an economic boom and majority of the companies chalk up huge profits, executives also enjoy big bonuses, as target performance is easily achieved or even exceeded, whereas in economic downturns the target performance standards may be decreased at the discretion of the board, so that managers can still enjoy their bonuses (justified by bad economic situation out of managers' control). I think, this is an unacceptable approach and evaluation should be done based on the comparison of own performance with the performance of other, preferably similar, companies. If target performance is achieved, but company performed at the below average level (as many other peer companies performed even better), than the payout of the target annual bonuses, from my point of view, is not justified. Its estimation should be reconsidered. On the other hand, if performance threshold is not achieved, but the company outperformed its competitors, reconsideration of bonus plan and payout of some incentives may be absolutely justified.

Hence, I assume, good comparable and generally accepted performance measures would be mostly suitable for short term incentive plans. I consider profit per share (and not earnings per share due to the reasons explained above), return on equity, as well as dividends payout ratio to be a good basis for performance evaluation on annual terms. When own values are identified, the relation to the values of the group of selected companies should be performed and potential bonus sizes should be determined. In addition, bonus banks should be applied as described above, in order to decrease drawbacks of the annual incentives on the long run.

**Long term incentives.** Having read various articles and books about long term managerial compensation components one may conclude that equity based compensation is the most contradictory component of the executive pay. This is mainly due to the drawbacks and lack of credibility of the stock option incentive plans as described above. However, the idea of aligning the interests of owners with the interests of principals by granting equity seems for me to be plausible. Only the ways and methods of doing this should be considered more carefully. From my point of view, various restricted stock grants may be a good alternative to massively criticized stock options and replace them soon or later. The grant amounts of the full value stock may be determined by some target measures, like for example in case of annual bonuses, and some restrictions should be also considered in order to eliminate short-term micromanagement possibilities, which directly influence stock price in favor of managers. All other features of the common stock, especially dividends payouts, should be kept also for restricted stock. If these considerations are taken into account, the restricted stock may become a valuable incentive for managers to pursue interests of the shareholders.

At the same time, equity should not be considered as the only incentive for managers in long run as proposed by many authors. There is also a justified place for multi-year target oriented cash compensations, based on performance measures in the similar way, as annual bonuses are calculated. Moreover, I consider bonus banks to be a good interlink between such long-term incentives and short-term annual bonuses.

Perhaps, for some companies it would be also reasonable to pay some portion of annual bonuses in form of the stock instead of cash. The corresponding number of shares to be granted can be then calculated as the cash amount divided by the average share price for the last 12 months. This would help to reduce the impact of the stock fluctuations in the before grant period and hereby to avoid short-term stock manipulations. At the same time the partial payout of short-term incentives in form of stock would imply an annual bonus with long-term incentive attributes.

## **2.4. Chapter Summary**

In the beginning of this chapter I have briefly introduced the origins of the executive-pay problematic, which lie within the principal-agent problem and represent an important part of internal control mechanisms of corporate governance. In publicly traded companies shareholders are principals and managers are agents. Each of the parties has own interests and objectives and differences between them generate so called agency costs. And the corporate governance system is called, among other objectives, to reduce these costs. Some main



solutions with related drawbacks were described and one of the most effective methods was considered to be the executive compensation.

Compensation contracts represent a powerful lever to reduce these differences and to motivate managers to act in the interests of shareholders. The optimal contract should make agency costs as small as possible; however, total elimination of these costs is impossible, since no perfect contract may be designed.

In the subsequent subchapters I gave an overview on the main components of the managerial compensation, such as base salary, short term incentives (annual bonuses), as well as long term incentives (mainly stock options and restricted stock). I have tried to disclose the most important issues of each component, discussed advantages and considered possible drawbacks.

With respect to base salary, among other things, I have pointed out the ever decreasing fraction of fixed pay in the total amount of compensation, as performance based pay boomed in recent years. Though, the importance of the base salary shouldn't be disregarded, as many other values are either connected to or based on the size of base salary. Hence, every additional unit of base salary involves an increase in the whole range of monetary and non-monetary components of the executive compensation, as well as in managerial benefits, pensions and severance arrangements.

In the subchapter about long term incentives I have almost exclusively focused myself on two main components: stock options and restricted stock. I have discussed the theoretical underpinning of stock options, as well as possible outcomes of using them as an incentive for decision makers. The main message was that stock options, alongside with performance oriented concerns of managers, may also stimulate perverse incentives, which are not align with the interests of shareholders.

The general remark is that managerial compensation contracts, no matter how complex they are, should be easy to understand and to communicate to managers. They should bear a clear message for what managers are rewarded and how they can contribute to it with their decisions and actions. Executives should admit contracting rules respectfully and truly believe in their realization and that there will be no significant exceptions or serious changes at board-level discretion in favor of executives. In the case of lack of communication and understanding, as well as the lack of belief in seriousness of incentive plans, even a very well designed plan is very likely to fail.

### 3. Transparency and Disclosure of Executive Pay

---

Historically, some issues of pay policy were kept in secret. This is not a sustainable position any longer. Shareholders, as well as stakeholders in general will perceive fairness of the managerial compensation policy only if they have information on sizes, components, determination methods and pay progression. Besides, not only awareness about compensations, but also understanding is considered to be very important. Armstrong and Murlis also point out, that a lack of transparency supports the belief that there is something to hide within organization: *“There is no chance of building a satisfactory psychological contract unless the organization spells out its reward policies and practices and the reasons for them. Transparency is achieved through effective involvement and communication”* (Armstrong and Murlis, 2007, P. 47).

Thus, transparency and disclosure policy on directors’ remunerations represent an integral part of corporate governance system of each organization. Still, the following questions need to be answered: what information, when and how detailed should/must be disclosed to shareholders/stakeholders? Recent developments all over the world prescribe a similar tendency: more transparency, higher disclosure levels, more detailed information available on executive compensations, as well as a publicly availability of company policy and methods of determining performance related compensation plans. Next I will take a closer look on these tendencies in the USA and Europe.

#### 3.1. Recent Tendencies in Disclosure Matters

In June 2008 the U.S. Securities and Exchange Commission (SEC) Chairman Christopher Cox has started the wide-ranging initiative to fundamentally rethink financial disclosure: “The 21st Century Disclosure Initiative”. According to the SEC web-site, the purpose of the initiative is to reconsider current forms-based disclosure system from the investors’ perspective and create a comprehensive report on how a modernized disclosure system should function, as well as concrete recommendations for its implementation. The cornerstone of the new strategic plan should be *“the new technology to collect, manage, and provide structured disclosure information that is dynamic, accessible, and easier to use, ... protecting investors, maintaining orderly markets, and facilitating the formation of capital”* (SEC, 2008). Considering that Corporate Governance standards of U.S. based companies are already very developed and imply high disclosure levels in international comparison, the current SEC Disclosure Initiative may also push other nations, as well as the European Union, to further development and improvement of their corporate governance systems in order to meet ever rising requirements.

In the European Union, corporate governance regulations are based on the national legislation. Each country is expected to adopt recommendations, issued by the European Commission. Thus, already in 2004 the Commission introduced guidance on disclosure and shareholder control over managerial compensations, which recommends *“that member states should ensure listed companies disclose their policy on directors’ remuneration and tell shareholders how much individual directors are earning and in what form, and ensure shareholders are given adequate control over these matters and over share-based remuneration schemes”* (EU-Commission, 29 December 2004).

However, these recommendations were not binding and member states of the European Community were free to adopt appropriate measures. In the follow-up report of the Commission from July 2007 it is stated, that the developments on the national levels have been overall very positive (EU-Commission, 13 July 2007). Namely, most of the member states introduced very high requirements with regard to the disclosure of the individual executive compensations; though, disclosure of the remuneration policy itself was not pursued that anxious. The another interesting point of the report is that the “say on pay” in determining the compensations for non-executive directors (supervisory board) has become a usual issue for shareholders, whereas only few countries considered “say on pay” on remunerations of the management board as necessary to be recommended, suggesting to let shareholders vote on remuneration issue only on advisory basis. At the same time, when it comes to equity-based compensation schemes, most of the Member States accepted recommendation to shareholder approval.

According to the Commission report, good developments within national regulations need to be continued and transparency degree should be enlarged. It is stated, that more transparency is always good: *“It is likely that a higher level of transparency will induce investors to be more active in companies’ affairs and claim greater involvement in remuneration matters. It may also contribute to the improvement of the standing of business and reinforce investors’ trust in corporate leaders”* (EU-Commission, 13 July 2007, P. 4).

Is that a reasonable argument that the remuneration policy of each listed company should be as transparent as possible or is there still some degree of transparency, which should not be overstepped?

### **3.2. Drawbacks of Transparency**

In the recent literature we may find arguments, which in some extent contradict the above stated recommendations of the legislator. For example, Hermalin and Weisbach in their

analysis of transparency came to the conclusion, that better transparency provides benefits, and at the same time it entails costs for the firm. Hence, there can be some optimal level of transparency and everything beyond that level would bring more costs than benefits. Thus, the legislator should act carefully in setting his mandatory disclosure regulations. The underlying explanation is pragmatic and can be summarized as following: more transparency is good, as the board gets better signal about the manager's quality and this provides better monitoring over the manager; but, this leads to increased risk of the manager to be exposed, entailing greater costs. The most important costs would be higher levels of compensation for greater career risk which manager faces, as well as costs caused by managerial incentives to distort information in costly and counterproductive manner as a reaction to increased transparency (Hermalin and Weisbach, 2007). From my point of view, these considerations on a possible negative impact of transparency on profits seem to be plausible even without complicated derivations and technical proofs, provided by the analysis of Hermalin and Weisbach.

A similar finding was discussed by Singh already earlier. Trying to track a connection between disclosure and pay size, Singh comes up with the following results: if managerial incentives are tightly linked to reported performance, this may cause a weaker connection between actual performance and compensation size, leading to decreased managerial efforts. Hence, the quality of reported performance may suffer from such incentives and controlling measures may create more costs than benefits for shareholders (Singh, 2006b). This finding concludes, that incentive contracts may worsen principal-agent problem and create more incentives for managers to misuse their position, given mandated disclosure levels are high and performance based remuneration models are applied.

Besides, Singh finds that the board may approve extensive incentive packages for the management in order to signal investors, that the company is well governed, as well as to protect its reputation of being an independent board (Singh, 2006a). These board-related drawbacks may be explained by so called "double" agency problem, when the principal tries to motivate the agent to work in his interests by using another agent with his own imperfect incentives, i.e. shareholders delegate compensation-related issues and performance supervision functions to the board, which has not very strong incentives to act in the interests of shareholders and first of all protects its own interests.

Similar considerations may occur, when speaking about auditors, who usually deliver independent opinions on the annual report. Commonly, managers provide auditors with information and the latter depends on cooperation to get the required information for building his opinion. Hence, auditor may have an incentive to be silent on some issues or to

“overlook” some facts, which are inconvenient for manager to be disclosed, so that the auditor keeps good relations to the management and can expect further cooperative attitude of managers, as well as receiving high-quality information. Such information exchange and better awareness of the auditor on what is really going on in the company may in its turn positively contribute to protecting shareholders interest. On the other hand, if there is a mandatory rotation, which should eliminate cooperative relationship between managers and the auditor in order to protect interests of shareholders, or if the auditor is very tough and conservative, who acts on his own by disclosing everything, managers may easily become reluctant to cooperate and to provide such auditors with necessary information. The bottom line is, that such strict attitude may cause more harm raising additional costs for investors, instead of protecting their interests.

### **3.3. Chapter Summary**

This chapter was entirely devoted to transparency issues, with its implications on executive compensation and firm value. First, I have presented general consideration, why transparency is actually important and why do listed companies need remuneration disclosure. This was followed by a brief overview of recent tendencies with regard to transparency, mainly in the USA and Europe, where I have shown that compensation policy disclosure is getting more and more attention of the legislator, which is trying to raise national and supranational requirements on mandated transparency and quality ever higher. The main message from a legislator perspective was and is that more transparency is always good for companies, and investors may only benefit from increased disclosure levels.

Further, I have tried to find out if such a statement may be proved or rejected. Some authors conclude in their recent analysis that transparency may entail also costs, which may be even higher than benefits, thus higher disclosure levels may reduce overall profits. The fact of existence of the optimal level of transparency is generally accepted, but its degree is not determined yet and is subject for further analysis. In other words, profit maximization requires some kind of tradeoff between benefits and costs caused by the given level of transparency. The optimum is though very difficult to determine in general and most probably should be assessed individually for each company in each given case.

## **4. Reflections on Praxis**

---

### **4.1. Legal Background of Directors' Remuneration in Austria**

All Austrian stock listed companies have to apply the Austrian Code of Corporate Governance, which provides a legal framework for the management and control of the enterprises. Rules of the ACCG are obligatory for all domestically incorporated companies according to “comply or explain” approach. Hence, each listed company has to state in its Corporate Governance report, if they obey ACCG-Rules or not; and if not, explanation should be provided, why it is not reasonable for the company to accept these rules.

Concerning management compensation Austrian legislation requires declaration of the total amount of compensation paid to the management and to the supervisory boards. This information should be disclosed in the annual report of the company. Besides, ACCG states that “the fixed and performance-linked remuneration components are to be disclosed for each individual member of the management board in the annual report”. However, only few Austrian companies accept this clause.

In addition, the remuneration report should include such severance benefits like golden handshake, retirement pay and etc. Regarding stock options the number and distribution of options granted and related shares should be disclosed within the annual report for each member of the management and the supervisory boards, employees and senior managers separately. Moreover, the nature of the contracts should also be disclosed, specifically the exercise price and its computation, as well as respective stock values at the time options are issued should be included. In addition, information on exercised options should be disclosed separately, i.e. number of options, exercise price and information on distribution (ECGI, October 2008).

### **4.2. Remuneration Sizes and Developments**

#### **4.2.1. Remuneration of Austrian Managers in General**

According to the information provided by the Austrian Managers Association (WdF: Wirtschaftsforum der Führungskräfte), an average remuneration of the Austrian top-managers since 1982 has been constantly increasing with 4.2% per annum on average (WdF, May 2008). If in 1982 an average top-manager earned a bit more than 62.000 € of total compensation, today this indicator reaches 182.000 €. Pretty much change at first glance, but if we take into account an average inflation rate of 2.57% over the same period, we get 93.989 € or about

1.6% of real growth\* per annum on average (Figure 4-1). WdF survey in 2008 was done based on the interviews of 682 managers, whereas 410 of them represented the top-management level.

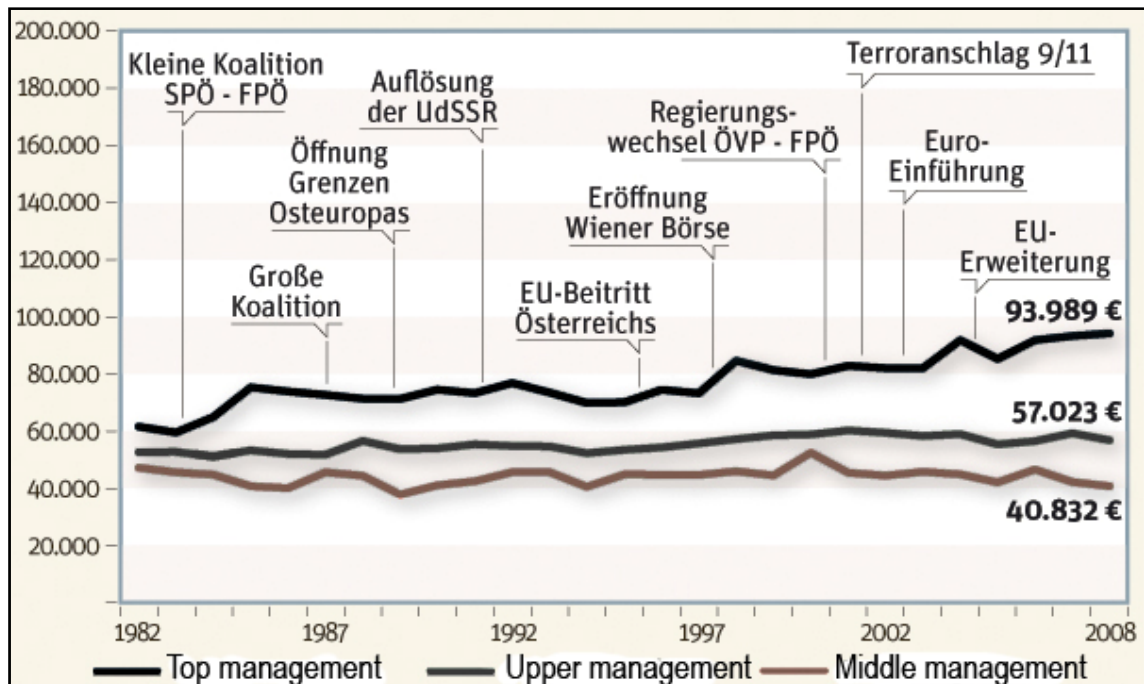


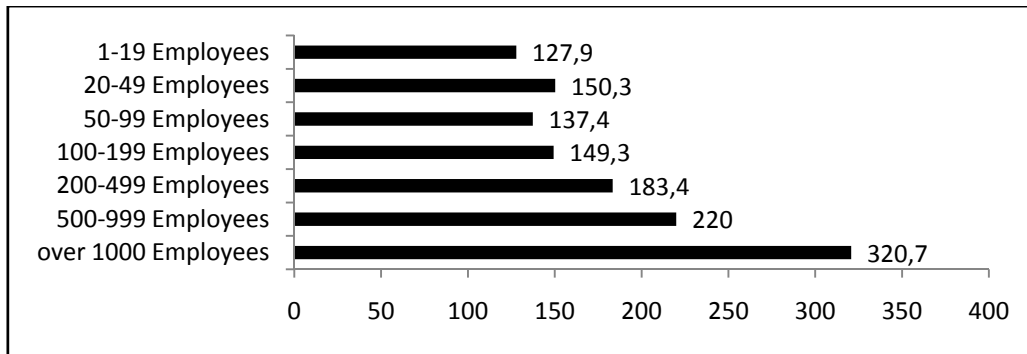
Figure 4-1: Development of managerial compensation in Austria since 1982 (inflation-adjusted)

Source: WdF – [www.wdf.at](http://www.wdf.at), taken from (derStandard, 30 May 2008)

An interesting finding is that more than half of interviewed managers had already successfully negotiated increase of their base salary in 2008 by the time they were interviewed, which makes 131.820 € on average for top-management level (out of 182.000 € total compensation). This only confirms the statement noted above in part 2.2.1 “Base Salary” that the fixed salary represents a highly valuable and important component of overall compensation for managers.

The provided results also point out some major factors, which are correlated with the pay size: total sales, number of employees, manager’s age, gender, education and etc. For example, top-managers of companies with 100-199 employees earn 149.300 € on average, whereas a position of a top-manager in the company with more than 1000 employees implies more than doubled personal payout of 320.700 € on average (Figure 4-2). Similarly, an average compensation of the representatives of the upper-management increases with the number of employees, but not that progressive as in case of the top-management: for instance, the upper-managers payout averages 106.900 € in the companies with 100-199 employees and increases by 30% averaging 139.000 € in the companies with >1000 employees. As the focus of my thesis lies within top-management level, I will skip further details on upper-management.

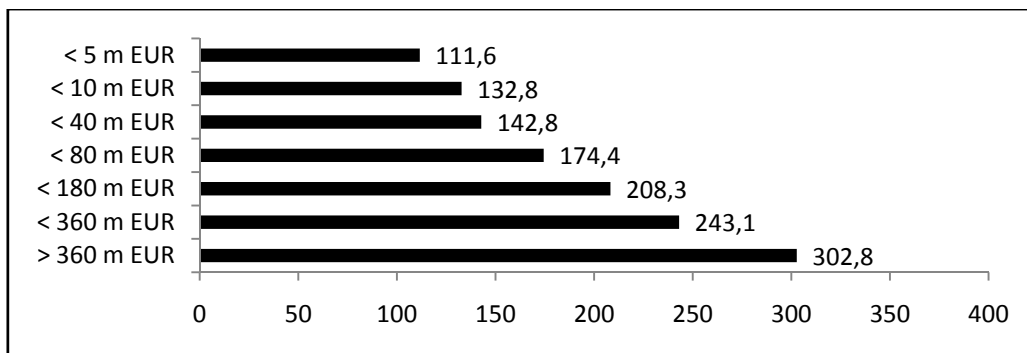
\* Underlying rate of an average inflation, as well as real growth rate was reproduced by me based on the WdF survey figures.



*Figure 4-2: Total compensation of the top managers in Austria, based on the number of employees. (average values, in 1.000 €)*

*Source: (WdF, May 2008)*

Also a positive correlation between total sales of the company and the top-management compensation is clearly to see on Figure 4-3, i.e. managers of the companies with less than 5 million € in sales get paid 111.600 € on average compared to executives managing companies with more than 360 million € in sales, whose total compensation averages 302.800 €.



*Figure 4-3: Total compensation of the top managers in Austria, based on total sales of the company. (average values, in 1.000 €)*

*Source: (WdF, May 2008)*

The age factor represents another positively correlated factor with compensation size. So, top-managers under 39 years get 148.200 € on average, whereas managers in the age-groups between 40-49, as well as over 50 receive 173.300 € and 200.700 € on average correspondingly. Also there is a significant difference between compensation levels of the male and female managers of highest seniority: 190.700 € against 122.800 € on average.

About 70% of all Austrian top-managers declared to receive variable performance-related compensation. In 2008 such bonus compensation amounted to 67.000 € on average, whereas in 2006 it was only 46.000 €. The main indicator for performance measurement was profit, which was taken in 76% cases for bonus size calculation. The second most important indicator was achievement of targets (55%), followed by turnover (30%), cash flow (18%) and value based measures (12%). Almost in all cases bonuses were paid out in cash; small part was also paid in form of shares and stock options. (WdF, May 2008)



#### 4.2.2. Remuneration of ATX Managers

Significantly higher compensation levels were observed when analyzing directors' remuneration of publicly listed Austrian companies, taken from the published annual reports for year 2007. According to the survey, carried out by the Austrian Chamber of Labor, an average top-manager of ATX-companies earned 1.300.426 €, which is more than 7 fold of an average Austrian top-manager compensation (AK, 2008). Also managerial compensation increase of 14% in listed companies implies much higher growth compared to 4.2% increase of Austrian top-managers' compensation in general.

	2005	2006	2007	Change
Average compensation in €	1.008.292	1.144.227	1.300.426	+14%

*Figure 4-4: ATX-Top managers' average compensation growth*

Source: (AK, 2008) [www.arbeiterkammer.at/pictures/d69/ATXStudie2008.pdf](http://www.arbeiterkammer.at/pictures/d69/ATXStudie2008.pdf)

Such growth could be explained by overall favorable economic conditions and high stock performance in the same period. Thus, for many top-managers of the ATX-companies it was possible to exercise stock options, received in previous years and consequently increase their total compensations considerably. In Appendix I will include graphs with stock performance of some selected ATX-companies, as well as of the ATX index itself. On the first graph we can clearly observe an increase of ATX-index price from below 2500 mark in January 2005 up to the double level of 5000 in the mid 2007, meaning about 100% plus in two and a half years, before it fell again to 4000 mark by the end of 2007. In 2008 followed further drop of the ATX-index to below 1500 mark, caused by worldwide credit crunch, liquidity problems and significantly increased investors' mistrust. This, however, is a subject for separate survey and discussion, so I will focus on before global crisis period.

Hence, the ATX-index fluctuation with overall growth in 2005-2007 clearly influenced total remunerations of the related managers. If we take a look on the five top compensations per manager we may observe similar correlation between stock price and the individual remuneration. Figure 4-5 shows that top compensations in year 2007 were paid by OMV AG, followed by Andritz AG, Erste Group Bank AG, with more than € 2 million average compensations, as well as by Telekom Austria AG and Intercell AG. Whereas in 2006 individual compensations of Telekom directors were higher than of the Erste Group directors; and position number five had been held by A-TEC industries, suppressed in the following year 2007 by Intercell AG.

	2007 Per manager in €1000	Compared to 2006	2007 overall in €1000	2006 Per manager in €1000	Compared to 2005	2006 overall in €1000
OMV	3.120	+30%	15.600	2.408	-14%	9.632
Andritz	2.386	+6%	11.928	2.260	+20%	11.300
Erste Bank	2.026	+8%	15.192	1.870	+3%	11.219
Telekom	1.247	-33%	3.740	2.123	+128%	6.368
Intercell	1.177	+11%	3.824	N/A	N/A	N/A
A-TEC industries	N/A	N/A	N/A	1.606	+60%	3.211

*Figure 4-5: Top 5 directors' compensations of ATX companies in 2007 and 2006 per manager (excluding Schoeller-Bleckmann, Voestalpine, Böhler-Uddeholm and Zimtobel)*

*Combined table, based on surveys of Austrian Chamber of Labor (AK, 2008) & (AK, 2007)*

Only in case of the Erste Group Bank AG I was not able to observe strong correlation of managerial compensation with stock performance in the given year. So, in 2006 the stock price increased from about 48 € up to about 60 €, being also down at 40 € in mid 2006; whereas in 2007 stock dropped again to ca. 44 €. At the same time, per manager compensation increased in 2006 by only 3% and in 2007 by 8% in spite of the stock drop.

In case of the other top payouts to managers, namely at OMV, Andritz, Telekom and Intercell, director's remunerations changed along with stock performance. Thus, I may assume that short term stock price based compensation methods were prevailing in these companies.

In the following chapter I will discuss some selected Austrian listed companies.

### **4.3. Discussion on the Selected ATX Companies**

Next I will select some of the largest companies listed in the Austrian stock exchange, which have disclosed detailed compensations of the individual managers in the annual reports for 2007. First, in Figure 4-6 I comprised a list of companies from ATX with market capitalization of more than 1 billion EUR.

Having checked annual reports 2007 of these companies I have surprisingly found out, that five out of ten companies disclose individual compensations: OMV, Erste, Verbund, Intercell and Wienerberger. It is surprisingly, because according to answers, given by Susanne Kalss in the ECGI-Questionnaire, only two issuers have accepted the clause 31 of the ACCG that the compensation of the management board is to be reported separately for each member (ECGI, October 2008). Kalss mentioned only OMV and Böhler Uddeholm, maybe that was the case earlier and now the disclosure policy of further ATX-companies have changed. Nevertheless, it opens possibility for closer examination of these few companies.

	Name	Number of shares outstanding	Free Float Factor	Stock Price (EUR)	Market Capitalization (EUR)	Market share
1	OMV AG	300.000.000	0,75	18,1	4.072.500.000	13,72%
2	ERSTE GROUP BANK AG	317.012.763	0,75	17	4.041.912.728	13,62%
3	TELEKOM AUSTRIA AG	460.000.000	0,75	11,26	3.884.700.000	13,09%
4	VERBUNDGESELLSCHAFT AG KAT. A	151.018.000	0,5	32,3	2.438.940.700	8,22%
5	VOESTALPINE AG	164.599.032	0,75	16,46	2.031.975.050	6,85%
6	VIENNA INSURANCE GROUP	128.000.000	0,5	23,93	1.531.520.000	5,16%
7	RAIFFEISEN INT. BANK-HLDG AG	154.667.500	0,5	19,24	1.487.901.350	5,01%
8	INTERCELL AG	47.207.256	1	22	1.038.559.632	3,50%
9	WIENERBERGER AG	83.947.689	1	11,98	1.005.693.314	3,39%
10	OESTERR. POST AG	70.000.000	0,5	22,81	798.350.000	2,69%
...	...	...	...	...	...	...

Figure 4-6: Largest representatives of ATX as of December 9th, 2008

Source: <http://www.indices.cc/indices/details/atx/composition/>

For such examination I would like to choose OMV AG and Erste Group Bank AG. Being among the largest Austrian companies, OMV and Erste, from my point of view, have one of the most developed corporate governance systems among ATX companies. These two representatives also have high disclosure standards, which allow me to analyze remuneration issues more detailed. Besides, differences in remuneration policy should make the analysis more interesting: at first glance I could observe tighter connections of managerial compensation with stock performance in case of OMV, as well as many other top ATX companies, whereas Erste seems to have remuneration policy, which is less related to the short-term stock performance.

#### 4.3.1. OMV AG Company Overview

OMV Aktiengesellschaft is the largest listed industrial company in Austria in terms of turnover and market capitalization (December 9<sup>th</sup>, 2008). OMV AG also represents one of the leading oil and gas corporation in Central Europe with group sales of more than 20 billion € in 2007 and employs 33,665 employees.

Originally, the company was founded in 1956 as a state owned company “Österreichischen Mineralölverwaltung Aktiengesellschaft” (Austrian mineral oil authority). In 1987 the first step towards privatization was taken, when 15% of capital stock was privatized. This was followed by further privatization and share offering events. Today 49,3% of the stock is in free float, while two major shareholders hold the rest of the stock:

- 31.5% ÖIAG (Österr. Industrieholding AG, Austrian state holding company)
- 19.2% IPIC (International Petroleum Investment Company, Abu Dhabi)

By extending its activities' in foreign markets, driven mainly by acquisitions and takeovers, OMV AG become one of the leading oil and gas corporations in Central Europe and is also present in the regions of the North Sea, Russia, the Caspian Region and Central Asia, Middle East and North Africa. Its activities range comprises Exploration and Production (E&P), Refining and Marketing (R&M), as well as Supply and Trading (S&T).

#### **4.3.2. OMV AG Managerial Remuneration Disclosure Policy**

According to the web-site of OMV, the Remuneration Committee deals with all matters concerning the remuneration of the Executive Board members and consists of the Chairman and further 4 members of the Supervisory Board. It is claimed, that directors' compensation has a strong performance related component and determined by means of "regular benchmarking against directors' payment at relevant Austrian industrial companies and the European oil market as a whole". The performance based compensation consists of short-term and long-term performance components.

The annual report 2007 includes individual compensations of the executive board members including the new board member Mr. Auli, where all components of remuneration are described in details. Due to disclosure, provided on the web-site, short-term incentives may include bonus agreements, mainly based on earnings, profitability and growth. Moreover, a short-term incentive plan may include special projects forming part of the Group's growth strategy. Long-term incentives consist of exclusively stock option plans, which are designed similarly as in other firms of comparable size. Stock option plans are also disclosed on the web-site of the company and also included in the annual report.

I have checked all annual reports available on the web-site of the company for years 2000-2007 and found out that OMV AG has been disclosing individual remunerations since 2002, i.e. since introduction of the ACCG to the publicity (1 October 2002). The year 2002 was also highlighted by major changes within executive and supervisory boards. Also the new auditor was appointed in 2002: Deloitte & Touche Group replaced Arthur Andersen Wirtschaftsprüfungsgesellschaft mbH after its demerger in 2002, however former Arthur Andersen auditors working within OMV AG also changed to Deloitte and continued their cooperation with OMV AG, giving their opinion in auditor's report. Thus, my focus will mainly lie within 2002-2007.

Comparing the annual reports for the focus years (2002-2007), I have found out that in the beginning only total remunerations to individual board members were disclosed, without explaining details. But year by year the quality of disclosure increased along with increasing

compensation sizes. Thus, in year 2007 full information on all compensation components was disclosed: fixed, variable, pension fund contributions, benefits in kind (company car, accident insurance) and reimbursed expenses, as well as information on stock options granted to and exercised by each board member.

OMV claims to be very transparent concerning its remunerations and to have strong performance related components. However, it is not that easy to find how much every manager earns effectively and to determine the overall tendency. The most confusing issue is changing notation within annual reports from year to year, as well as differences in disclosing the components in different years.

For instance, referring to “basic remuneration” the annual reports 2002-2005 meant both fixed salary and variable short-term compensations, whereas “basic remuneration” in further years referred exclusively to fixed salary. Thus, it is not transparent what the real fixed salary in the previous years was and what part of the “basic remuneration” should be considered as performance related. The reason for such difference could lie within accounting standards. In fact, due to the EU Regulations OMV Group adopted IFRS instead of US GAAP for its consolidated accounts with effect from January 1, 2005.

According to the annual report 2006, the total remuneration of the 4 executive directors in 2006 was € 9.632.000, whereas the report 2007 claims that 5 directors were paid less in 2007, namely € 8.153.000 in total. After close comparison of these two reports I discovered an explanation, i.e. the total remuneration 2006 included exercised stock options, whereas exercised stock options were disclosed separately from remuneration issues in 2007. Adding up stated total remuneration and exercised stock options in 2007 I came up with € 15.600.000 in total for 5 directors; hence the real amount of the total remuneration almost doubled. This amount corresponds with the values from Figure 4-5, provided by the Austrian Chamber of Labor.

Before I jump to any further conclusions, I would like to take a more detailed look on the components of the OMV AG directors’ compensations, trying to find out composition relations and developments since introduction of individual compensation disclosure in 2002.

#### **4.3.2.1. OMV AG Base Salary**

After heavily grappling with figures from annual reports 2002-2007 I could finally split “basic remuneration” into base salary and variable compensation. Results are comprised in the appendix in table A-3, as well as charts A-4 and A-5. The average basic salary of 4 executive board members increased steadily in the period from 2002-2006 with 8,6% increase per

annum (from 380.000 € to 529.000 €), whereas its share in total compensation kept decreasing. In the year 2007 base salaries of the four old board members stayed unchanged and the new member joined the board with a base salary of 350.000 €.

Such a tendency to increase base salary proves to be consistent with the findings from the theoretical part of my thesis (Chapter 2.2.1): the tendency of reducing share of salary in total compensation, but not reducing it in absolute numbers. Also, once the base salary is increased, it will probably be never reduced again. How it was set initially, as well as the reasons for the ongoing growth of the base salary, other than increased experience of managers with years within the company, may not be clarified based on the available information. Thus, one can only make assumptions on base salary determination. My assumption would be that the base salary was determined based on benchmarking results against competing companies within Austria and Europe and was set based on market price of such managers. To check and to assess if this may be the case in the reality would be very complex and extremely time-consuming, so I will go on with other remuneration components.

#### **4.3.2.2. OMV AG Short-Term Performance Related Compensation**

The variable part of the compensation, based on short term performance has been also constantly increasing since observation beginning in 2002. Table A-3 shows that the total variable compensation doubled in the one year period from 745.000 € in 2002 to 1.479.000 € in 2003 and stayed relatively stable on this level over the following three years, before it almost tripled in the year 2006 and reached 4.748.000 €. In 2007 a slight increase was observed, moving short-term variable component closer to the 5 million € mark.

However, the relation of the variable part to total remuneration has not only increased, but also decreased in some periods. Namely, in 2002 its share was 29%, which increased to 39% in 2003, followed by decreases in 2004 and 2005, when it finally reached its lowest level at 15,1%. In the following year 2006, when the total compensation was reduced, while the variable pay significantly increased in absolute terms, the share of the variable pay in total compensation increased up to 49%. This ratio decreased again to 32% due to highly increased total compensation in 2007.

Thus, only 2003 and 2006 represent distinguishing years, when short-term variable compensation increased substantially. What could have been the factors behind these changes? In order to assess this, I refer to the following statement, taken from the annual report 2007: “The short-term incentives are bonus agreements based on earnings, profitability and growth targets”. However, it is not stated which period of time should be considered as

short-term; based on the discussion from the theoretical part 2.2.2, I will assume, that one year performance targets and results are used to calculate short term performance related compensations.

Below in the table A-6 I have summarized the most important indicators (Sales, EBIT, Net income, Balance sheet total, NOPAT) and ratios (ROACE, ROE, DPS) for the period 2001-2007. Looking for targets and objectives of the company I have found out the only measurable target, which keeps stable over the years, namely ROACE of 13% under mid-cycle market conditions. Other targets related formulations are abstract and it is not possible to find out exact numbers behind them based on annual reports and other available publications. Hence, I will assess the performance development based on the above mentioned measures and try to find out connections between results and variable compensation fluctuations in 2002-2007.

It can be observed, that in a year 2002 only the Balance sheet total increased by +7%, whereas Sales decreased by 8%, EBIT changed by -19%, Net income by -15% and NOPAT by -16% compared to 2001. Also profitability ratio ROACE decreased from 14% to 11%, below the target ratio of 13%, as well as DPS was reduced from 0,43 € per share to 0,35 € per share. Thus, considering such performance no substantial short-term bonuses could be expected in 2002. Nevertheless, 701.000 € were paid to the executive board as performance based bonus. This lets me to conclude, that either the bonus plan policy in year 2002 was poor or the short-term incentive plan was based on other than above mentioned measures. Another explanation could lie within external factors and decreasing oil prices at that time, thus the whole oil industry could have been confronting difficulties and OMV AG could have outperformed its rivals, even with reduced overall performance.

In the year 2003, however, the situation changed and OMV achieved +30% EBIT, +26% NOPAT, +22% Net income, as well as higher Balance sheet total (+22%) and increased Sales (+8%). Also ROACE and ROE ratios increased slightly reaching 12% and 15% respectively and DPS reached 0,4 € per share (+14%). Consequently, the executive board was also rewarded with higher performance related bonuses, which amounted to 1.479.000 € in total (+111%).

The year 2004 was also a very good year, distinguished by high increases in Sales (+29%), EBIT (+51%), Net income (+63%), Balance sheet total (+76%) and NOPAT (+65%). ROACE was above the target ratio and reached 15%, whereas ROE was as high as 19% and DPS in the amount of 0,44 € per share was paid out (+10%). Also an important acquisition of the Romanian largest company Petrom took place, where OMV took over control of 51% of Petrom shares. Due to the consolidation of the Petrom acquisition the head count at year end was up from 6,137 to 57,480, including 51,005 Petrom employees. Interestingly, the variable compensation based on

performance decreased in this year by 5% and amounted to 1.405.000 € despite of all this performance, profitability increases and other achievements.

The next year 2005 was an outstanding year with doubled profits and increased overall performance: Sales +59%, EBIT +101%, Net income +96%, Balance sheet total +17% and NOPAT +108%. Moreover, ROACE and ROE reached 20% and 19% respectively, with doubled DPS size amounting to 0,9 € per share. Hence, an increase of 20% in variable performance related compensation was observed, which amounted to 1.691.000 € in total.

As performance increased that rapid in the year 2005, it was not possible to keep the same growing pace in the following years. However, good overall performances with a slight positive change were achieved in years 2006-2007. So, Sales increased by 22% in 2006, followed by +6% in 2007; EBIT showed +5% and +6% correspondingly; Balance sheet total grew by 15% in 2006 and 19% in 2007; NOPAT also continued to increase with +13% in 2006 and +11% in 2007. Whereas return on average capital employed and return on equity ratios decreased slightly, i.e. ROACE to 16% in 2007 (18% in 2006) and ROE to 19% (20% in 2006), but still implied high above target ratios. Also the DPS increased in both years to 1,05 € and then to 1,25 € per share, implying 18% average growth per annum.

Highlight of 2006 was the acquisition of a 34% interest in Petrol Ofisi, the leading oil marketing company in Turkey. A positive side-effect of the acquisition was the achievement of the target, originally set for 2010, namely 20% market share in Danube region.

And it was the year 2006, when variable compensation of the executive board skyrocketed to 4.748.000 €, amounting to almost 50% of the total compensation in that year and this was almost tripled bonus size compared to the year before in absolute terms. In the following year a short-term variable pay increased further by 5% and reached 4.993.000 €, whereas its share in total compensation shrunk to 32%.

Thus, no straightforward impact of the annual performance to the size of performance based variable compensation of the same year could be determined. Also it is not very clear, what exactly caused such a significant increase of this compensation component in absolute, as well as in relative terms in year 2006. Though OMV claims to have transparent remuneration policy and discloses individual managerial payouts in details, there is a disclosure shortage with regard to variable compensation formation. It is also not clear, based on what measures and targets the ever growing variable bonuses are determined.



In the chapter 3.2 “Drawbacks of Transparency” I have discussed findings of some authors, who point out possible negative impact from increased transparency and conclude that there should be some optimal degree of transparency. I may assume, similar considerations could have forced major owners of OMV, Austrian Industry Holding (ÖIAG) with 31.5% stake and International Petroleum Investment Company (IPIC) with 19,2% stake, together with supervisory board to avoid too much transparency on remuneration policy.

Another assumption would be that OMV internally practices remuneration policy based on rather non-financial measures and not on classical financial figures, despite it is stated otherwise in the annual reports. This assumption is consistent with findings, discussed in the chapter 2.2.2 “Short Term Incentives” that industrial companies more often implement non-financial measures for short term bonus plans. If this is not the case and financial measures are eventually used, than existence of internally regulated provisions on “bonus banks” could explain smoothening of payouts over several years (see chapter 2.2.2). Particularly, significant increase of the variable pay in year 2006 after very successful financial years 2004-2005, but rather ordinary success in 2006, could be explained if such “bonus banks” were applied. This however would contradict with the explanation given in the annual reports of OMV AG and would relate the variable compensation to the long-term and not short-term performance. In fact, according to the information given in annual reports, the only long-term performance based compensation is based on stock option plan, which I will discuss in the following chapter.

#### **4.3.2.3. OMV AG Stock Option Plans**

Stock option plans are designed for senior executives, particularly for the members of the executive board and were introduced in year 2000 for the first time within OMV AG. The approval of the stock option plan is provided by the resolutions of the Annual General Meetings. Such stock options may represent an award of shares at a fixed exercise price or may be entitled in form of cash or shares, which correspond to the difference between the market value of the stock on the exercise date and the exercise price. The Black-Scholes model is used in calculating the fair values of the stock options granted at grant-date, as well as at the subsequent balance sheet dates (OMV AG Annual Report, 2007, P. 85).

Under the stock option provisions the share repurchases were performed, which were also approved by the Annual General Meetings for the years 2000-2007. Repurchased own shares are accumulated with the intention to cover conversions for exercised convertible bonds, as well as for covering stock option plans.

The exercise price in years 2003-2007 was an average stock price in the period from May 20 to August 20. Options are allowed to be exercised when the market price exceeds the exercise price by at least 15% at the time of exercise. Since the beginning of the stock option program, only in year 2002 it was not possible to exercise any option, because market price was below threshold price.

In the table A-7 I have summarized stock option plans for the whole period 2000-2007 and in the table A-8 I have illustrated options exercised by splitting them into years, when they were granted. It can be observed that in the first years 2000-2003 there were 5 year stock option plans with a 2 year holding period. In the following years the expiration was changed to 7 years, whereas vesting period stayed 2 years.

The stock options granted in the year 2000 were exercised immediately when it became possible to do so in the year 2003, namely after the expiration of vesting period and fulfilling of the threshold condition (when the stock price on the market exceeded exercise price by more than 15%). Exercised 111.300 options entitled four top executives to receive 296.000 € in cash or in share equivalent. However, options granted in the year 2001 were not exercised in 2003, as their exercise price was set at a higher level and therefore threshold was not reached after vesting.

In year 2004 executive directors exercised all options granted to them in the 2001 (84.000) and part of the options granted in 2002 (77.900 out of 223.100). This in the course of increased stock prices allowed them to earn over 1 million € in total in addition to their compensation.

Further, as it can be observed in the figure A-10, stock increased significantly in the year 2005 and executive managers could exercise their options (229.000) at market price of 41,3 €, whereas the average exercise price of these options was 10,2 €. This led to the payout of more than a 7 million €, which made about 64% of overall compensation in 2005. However, this was less than a half of the vested options, which were exercisable in that year; and 252.000 options were kept for the following years.

In year 2006 only 72.000 options out of 490.800 vested options were exercised by executive managers. Corresponding value of these exercised options was 2.155.000 €, almost 5 million € less than a year before, thus amounting to 22% of the total compensation. This year was the only year, when overall compensation shrunk, but due to the highly increased variable bonuses, the total compensation decreased by only 1,6 million €.

In the year 2007 almost 200.000 stock options were exercised by executive board members, 85% of which were granted in 2003. Payout from exercised options in 2007 amounted to about

7,5 million € (48% of total compensation). 412.150 options were left unexercised, including 191.200 stock options granted in the year 2005 with exercise price of 34,7 €.

In general, since the introduction of the stock option plan in 2000, stock options became the most important component of the executive compensation. The number of granted options rose in 2001-2003 and reached the maximum in year 2003 with 336.000 options granted, thereof 42.000 were still unexercised by the end of 2007. In the following years 2004-2007 the number of options granted continuously reduced and reached 98.400 options in 2007. Annual reports do not provide information on how the number of options to be granted was determined in each year. I have observed the negative correlation of options granted to exercise price, i.e. less stock options were granted, when stock price increased.

In the most cases, options were exercised after 3 years, i.e. 2 or 4 years before plan expiration. When a big number of options were granted, the part of them was kept unexercised over vesting. As it can be observed from the table A-9, different executives followed different strategies with regard to exercising. For example Mr. Ruttensstorfer, Chairman and CEO, kept exercising almost the same number of options year by year, whereas Mr. Roiss, Deputy Chairman, exercised his most options in 2004-2005, a small part in 2006 and none in 2007. Nevertheless, Mr. Roiss managed to exercise more options than other board members and consequently he accumulated the smallest number of vested options by the end of 2007. Other two board members also exercised their options in different manner, what lets me to conclude that managers had more or less different expectations concerning future stock performance. Otherwise all four executives would have exercised their options in similar way.

More than 90% of all exercised options were paid out in cash and only a small fraction of employees preferred to get share equivalent instead of money. However, it is not clear, if managers' preferred more shares than the average did.

Concluding, I would like to point out the following from my point of view most important issues regarding the OMV AG stock option plans for executive directors:

- High compensations resulted from stock option plans were observed when the stock price increased significantly. The overall favorable economic situation and high oil prices have influenced such increase. The ATX Index performed similarly well (see figure A-10).

- Due to the global credit crunch and significant decrease of fossil fuel prices the share price of OMV AG was below 20 € mark by the end of 2007, what makes the huge reserves of vested and not yet exercised options from previous years with relatively high exercise prices rather unattractive as incentives in the future.
- The fact that big amounts of stock options were granted when stock price was low and had high potential to grow, whereas small amounts of stock options were granted when stock price was already high and had tendency rather to decrease, makes the whole stock option program questionable as a long-term incentive plan.
- The vesting period of only 2 years, as well the actual exercises after 3 years on average after granting attributes the stock option plans rather to the mid-term and not to the long-term incentives.
- If stock price of the OMV AG continues to reduce further in 2009 and reaches the lowest possible price in may-august 2009 when the new stock options are granted and the exercise price will be determined, the potential payout of these options in the future will increase substantially. Hence, under the given circumstances managers may theoretically try to influence the stock price negatively, what is contradicting with the original incentive idea why stock options are actually granted.
- Regarding transparency the disclosure situation in case of the stock option plans is similar to the variable performance based compensation: individual allocations, exercise amounts, as well as fair values on balance sheet dates are disclosed, whereas underlying information about origins of these amounts granted is not clarified.

#### **4.3.2.4. OMV AG Other Compensation and Costs for Former Executives**

In addition to the base salary, the short-term variable bonuses, as well as the long-term incentives in form of stock options there are also “pension fund contributions” and “benefits in kind”, which are disclosed within the separate remuneration sector of the annual reports. The table A-3 provides information on these compensation components over 2002-2007. On average retirement contributions in sum with benefits in kind amounted to 7,3% of total compensation. In absolute terms they amounted to about 75.000-95.000 € pro board member in 2002-2005 and increased to about 150.000 € pro board member in 2006-2007. The individual allocations, as well as a split of pension fund contributions and other benefits for 2006-2007 may be found in the table A-2. Such detailed information on this compensation component was published in the last annual report for 2007 for the first time. The annual reports of previous years disclosed total retirement contributions in sum with benefits without

providing information on the individual distribution. From that table it can be observed, that other compensation mainly consists of pension fund contributions, whereas benefits in kind, such as company car, accident insurance together with reimbursed expenses amount to 8.000-9.000 € per board member per annum.

Information on the compensation of former members of the Executive Board and their surviving dependants has been disclosed since IFRS replaced US GAAP as company's accounting and disclosure standard in 2005. Before, under the US GAAP standards the compensation of former executives was disclosed for the whole group including affiliated companies in total. Thus, former members of the Executive Board and their surviving dependants received 1,25 million € in 2004, 1,11 million € in 2005, 1,12 million € in 2006 and 1,04 million € in 2007. However, it is not stated how many former board members were entitled to this compensation, when they have retired and how many years payouts will last.

Also stock options were exercised by former executives after their retirement, providing them with an additional compensation of 313.000 € in 2004 and 255.000 € in 2005. This contradicts the principle of the stock option plans, which were described in chapter "2.2.3.1 Stock Options", namely that stock options usually may not be exercised if the option holder leaves the company before the vesting period expires.

#### **4.3.1. Erste Group Company Overview**

The Erste Group is one of the largest financial services providers in Central and Eastern Europe in terms of clients and total assets. Originally it was founded in 1819 as the first Austrian savings bank ("Erste oesterreichische Spar-Casse"). The IPO took place in 1997 and the raised capital was used in expanding retail business of the Erste Group into Central and Eastern Europe.

Numerous acquisitions, as well as a rapid organic growth increased Erste Group's customer base from 600.000 in 1997 to 16,6 million in 2007, thereof 15,5 million clients living in the European Union. Today the Erste Group is present in 8 countries (Austria, Czech Republic, Slovakia, Romania, Hungary, Croatia, Serbia, Ukraine) employs more than 54.000 employees and has over 3,000 branches ([www.erstegroup.com](http://www.erstegroup.com)). The strategic focus has been retail banking and SME business.

The CEO and chairman of the management board of the Erste Group, Mr. Andreas Treichl was claimed to be the highest paid manager in Austria in 2004 and 2007 with total compensation of about 4,5 million € (Format, 14.4.2005) & ([manager-magazin.de](http://manager-magazin.de), 11.07.2008).

The Ownership structure of the company is illustrated in chart A-18. The ERSTE Stiftung (engl. Erste Foundation) is by far the largest shareholder of the Erste Group and holds 31,1% of the shares. Another major shareholder is "Austria Verein" with only 5% of the shares. The shares in free float are mainly owned by institutional investors (46,1%). Not uninterestingly, the chairman position in the management board of the Erste Stiftung, the largest shareholder of the Erste Group, is occupied by Mr. Treichl, the chairman of the management board of the Erste Group. This is an important fact with regard to remuneration policy, as compensation issues, particularly decisions on bonus payments, are attributed to the competence of the supervisory board and Erste Stiftung, being a major co-owner of the Erste Group, takes part in nomination and voting processes for the supervisory board composition on a large scale.

#### **4.3.2. Erste Group Managerial Remuneration Disclosure Policy**

Since 2004 Erste Group Bank AG has been publishing compensation details for each individual member of the management board within the annual financial reporting. In the annual report 2007 it is pointed out that "the total remuneration of the management board is structured so as to be aligned as closely as possible with the interests of shareholders" (Erste Annual Report, 2007, P. 11). Total compensation comprises such components as fix salary, performance-related bonus, non-cash compensation and share options.

Key levers, which influence the size of performance-related compensation, are return on equity (ROE) and the size of the dividend as a percentage of the stock price. Bonus cap is 117% of the base salary, which is reached when the dividend payment surpasses 20% of the share capital and ROE of 16% is achieved. Share options are not allowed to be exercised unless the ROE stays below 17%. In addition, separate bonuses may be awarded by the supervisory board from time to time when extraordinary performance is achieved. The last clause may be found only in the last annual report for 2007, however such a separate bonus amounting to 2 million € was paid to the CEO in 2004

Since 2004 there have been several changes within the management board, namely the replacement of Mr. Horovitz in 2004 after his being a board member for 1,5 years by Mr. Coreth, who was also replaced later in 2006 by Mr. Spalt. In addition, two board members also retired in 2007 and five new executives joined the management board in the same year. Taking into account the possible impact of these changes on the remuneration assessment I have decided to select the top five highest paid managers in 2004-2007 and discuss their compensation components. Table A-11 provides a breakdown of remunerations of selected

top five executives, whereas table A-12 comprises the total compensation of other members, which either joined or left the management board between 2004 and 2007.

With regard to an independent auditor, there is a strong continuity since Erste Group went public. Since 1998 the Erste Bank's financial years have been audited by Sparkassen-Prüfungsverband as the legally mandated auditor. Besides, the Annual General Meeting appointed a supplementary auditor, which was Deloitte Wirtschaftsprüfungs GmbH for the financial years from 1998 to 2006, replaced in 2007 by Ernst & Young Wirtschaftsprüfungsgesellschaft mbH.

#### **4.3.2.1. Erste Group Base Salary**

Base salary of the management board members represents a significant part of their overall compensation and stayed relatively constant within the last 4 years (table A-13). Of the five selected executives, the highest fixed salary is assigned to the chairman of the board Mr. Treichel, which amounted to about 1,2 million € in 2004 and 2005, followed by marginal increase of 45.000 € in 2006 and insignificant decrease of 6.000 € in 2007. The base salary of the deputy chairwoman Ms. Bleyleben-Koren amounted to 75% of the salary of the chairman and averaged to 0,91 million € in 2004-2006, before it dropped to 831.000 € in 2007. Further two board members enjoyed a fixed salary of 62,5% of the chairman's level, whereas the fifth selected executive received about 500.000 €, what made 42% of the chairman's salary. Relative to variable compensation, the fixed part averaged to 41% of total compensation in 2004-2006; its share in total compensation in 2007 was below 27%.

All in all, the base salary of the each of five board members stayed constant in 2004 and 2005, increased in 2006 and decreased in 2007. Significant drop of the base salary in 2007 in case of Mr. Ortner and Mr. Erasim is explained by their exit in mid 2007, whereas slight decrease of the fixed salary of the remaining members may be explained by the enlargement of the management board size from 6 to 9 persons and partial transfer of the responsibilities covered by the six board members to the three newcomers.

From now on, 4 board members belong to Austria Committee and 6 board members to Holding Committee, including Mr. Spalt belonging to both committees.

With regard to the transparency, it can be concluded that the Erste Group successfully adopted ACCG recommendation to disclose a split of the fixed compensation of the individual members of the management board; however, there are no provisions on how these amounts were generated and under what terms changes took place.

#### **4.3.2.2. Erste Group Performance-related Compensation**

Variable part of the compensation of the five highest paid executives of the Erste Group in 2004-2007 was on average 30% higher than their base salaries. Its average amounted to 1.084.000 € in 2004, 939.000 € in 2005-2006 and 1.188.000 € in 2007. Interestingly, higher average bonus in 2004 and 2007 occurred due to the significant bonus payouts to the chairman of the board member (3 and 2,8 million € correspondingly) in those years, whereas other four board members received higher or at least the not smaller bonuses in 2005-2006 than in 2004 and 2007 (except Mr. Ortner).

According to the information, given in the annual report 2007, variable bonus is capped at 117% of the base salary level, once dividend payout ratio of 20% and return on equity of at least 16% are reached. This contradicts with my finding, that variable bonus was on average 30% higher than base salary in 2004-2007, which exceeds the maximum bonus of 117% of the annual gross salary.

In order to find out relation of the company performance to directors payout I have selectively comprised main performance measures and key ratios in the table A-17, as well as in the chart A-16.

The year 2004 was distinguished by remarkable performance and increase of the all important performance measures as well as company size: total assets increased by 8,7% and amounted to almost 140 billion € and net income (interest and commission income) raised by 5,9% to 3,8 billion €; DPS and EPS also increased by 32% and 19% correspondingly. Besides, ROE reached 17% mark, whereas dividend payout ratio dropped by 10% to 23,2%, which is still above 20% point needed for bonus maximization. This drop in payout ratio occurred mainly due to highly increased profits (+47,4%), which reached 521 million € in absolute terms and consequently increased market capitalization, which jumped by more than 60% and reached 9,5 billion €. In this year all 5 managers received bonus, which amounted to 83,3% of their base salary. In addition, the supervisory board entitled the chairman of the management board to receive one-time exceptional bonus of 2 million €. Hence, 117% cap on variable bonus was not reached by the top five managers in this year (excluding one-time exceptional bonus to Mr. Treichl), even though payout ratio and ROE were higher than 20% and 16% correspondingly.

In 2005 similar increases of the performance indicators were published: 9,2% increase in total assets, 6,7% in net income, +10% in DPS and +36,7% in EPS. The key indicator ROE reached 19,5%, the highest level in the history of the Erste Group Bank AG, whereas dividend payout ratio dropped further by almost 20% and reached 18,7%, which is below 20% mark.



Nevertheless all 5 managers received higher bonuses than in 2004, which surpassed 110% of the base salary and in case of two managers almost reached the maximum of 117%.

In 2006 the key ratio ROE, which is responsible for variable bonus determination dropped by almost 30% to 13,8%. Other indicators showed positive development: total assets increased by 19% and amounted to 182 billion €, net income by +14,4%, net profit by +30% and reached 932 million €; DPS increased by 18,18% and EPS by +5,37%. Higher dividends raised dividend payout ratio by 17,65% to 22%. As maximum allowed bonus was almost reached in the previous year, there was no possibility compensate managers with higher bonuses also in 2006. Hence, base salary of all managers was increased slightly (by about 3,76% on average), whereas variable bonuses of the same amount were paid out as in the previous year comparing in absolute terms, whereas its relation to base salary decreased correspondingly.

Further performance increase was secured also in 2007, when net income, net profit and earnings per share all increased by about 25%, whereas total assets topped 200 billion € due to 10,4% increase. DPS, similarly as in 2006, increased again by 0,1 €, implying +15,4%. The key ratio ROE was mobilized again with +5,8%, but stayed below 16%, whereas dividend payout ratio decreased by 8,18% to almost 20%. Regarding bonus compensation, annual report 2007 states, that “in the case of three board members the supervisory board awarded such (one-time) bonuses in 2006” (Erste Annual Report, 2007). However, these separate bonuses couldn't be observed in the remuneration report for 2006, whereas report for 2007 includes increased bonuses for 3 board members, which exceed maximum bonus size (117% of base salary). According to Wirtschaftsblatt, the chairman of the board was entitled to receive 1,8 million € as an extraordinary bonus for outstanding performance in the year 2006, which was paid out in 2007 (Wirtschaftsblatt, 30.10.2008). Hence, I assume also other 2 board members received their extra-bonuses in 2007. This information is not clarified by the annual reports for 2006 & 2007.

Based on the given information it can be observed, that variable compensation of the chairman in 2007 increased by 108% compared to 2006 and amounted to 2,8 million €, namely 227,6% of the base salary. The bonus paid to deputy chairwoman decreased slightly, but due to decreased base salary made 123,1% of the size of base salary. Also the total compensation of Mr. Hochstrasser decreased in view of decreased base salary, as well as reduced bonus compensation, which amounted to 93% of the size of his base salary. Two other board members left the management board in the mid 2007: Mr. Ortner received over 1 million € as a bonus, what amounted to 251% of his halved base salary, whereas Mr. Erasim received 438.000 € bonus compensation (164% of his halved salary).

Thus, direct relation of the annual performance to bonus sizes in 2004-2007 was observed. This impact, however, proved to be rather short-term performance driven. In matters of disclosure, overall transparency level with regard to bonus compensation is high, however many issues remain unexplained. Thus, it is clear how the maximum bonus size relative to base salary can be achieved, whereas it is not stated how lower bonuses are determined and what minimum performance is required to receive a bonus at all. If one-time extraordinary bonuses are excluded, it can be observed that all five executives were rewarded the same bonus rates relative to their base salary, namely it is not distinguished who had been responsible for the achieved results and whose commitment was higher.

It should be also pointed out, that in the course of the financial crisis in 2008, Mr. Treichl announced to forego his bonus payment for 2008. Hence, he will mainly receive only his fixed salary, which is still over 1 million €. According to his statement, the total compensation for 2008 will thus amount to 20% of what he should have received, if the crisis had not occurred (Wirtschaftsblatt, 30.10.2008).

#### **4.3.2.3. Erste Group Management Share Option Plan**

Share-based payment of the Erste Group is regulated and carried out on basis of the management share option plans (MSOP). These are recognized and measured in accordance with IFRS 2 (Share-based payment). The fair value is determined on the grant date using generally accepted pricing models and any expense resulting from option grants under MSOP is spread over the vesting period between the grant date and the first permitted exercise date. These expenses are recognized as personnel expense.

MSOP was initiated in 2002 for the first time, when 60.000 options for the five management board members (12.000 per person) were allocated. These options were delivered in three tranches in April 2002, April 2003 and April 2004: 4.000 options each year. The exercise price was set based on the average stock price in March 2002, which was 66 €. After a share split of 4:1, performed in 2004, each option entitled recipients to purchase four shares at a price of 16,5 € ( $66 \text{ €} \div 4$ ). After exercising the options under MSOP and physically buying out some amount of the shares, there is a lock up period of one year, when no more than 15% of the shares purchased through options are allowed to be sold. This is the distinguishing feature of the share option plans of the Erste Group compared to other companies.

The next MSOP was started in 2005, which granted the whole management board with 72.000 share options to buy company stock at a price of 43 € per share. To the six highest ranked

managers 9.000 options per person were allocated. These options could be exercised also in 3 equal tranches over the following 3 years.

According to the annual reports, all 60.000 options granted to the top managers under MSOP 2002 were exercised by 2005, namely the 5 highest ranked executives purchased 240.000 shares for 3.960.000 € in 2004-2005. However, options granted under MSOP 2005 were not that attractive due to the higher exercise price. Hence, only 18.000 out of 72.000 options were exercised by 2007, leaving 54.000 options unexercised. Today in course of the financial crisis, the stock price dropped below 20€ per share, making MSOP 2005 useless for its recipients at least as long as crisis continues and stock price stays below exercise price.

In the table A-19 I have combined information on share holdings by the top 5 highest ranking executives of the Erste Group, pointing out yearly additions (including share option exercises), as well as yearly disposals. It can be observed that 5 highest executives used share option plans mainly to buy stock and to accumulate it beyond the lock-up period, thus investing their money without immediate payback. This may be considered as a better incentive, than the classical stock option compensations, when recipients do not need to invest anything but wait until vesting period is over and stock price is higher than exercise price, so that it becomes possible to exercise options and get immediate difference in cash without own investments.

Also the disclosure level with regard to the share option plans can be considered to be very transparent and clear. As far as I could determine, share option plans were consistent with IFRS 2 (SHARE-BASED PAYMENT) during at least 2002-2007 financial years. The only missing information is the value, transferred to the managers by exercising options. The total remuneration disclosure given in annual reports does not contain any hints on this matter. Until now this made also not a big difference, as gains from sold shares were not very high and amounted to a small fraction of the overall compensation. However, this may change in the future and pointing out gains or at least information on the average price at which shares were disposed during the given year would be reasonable from my perspective. Also losses may occur if executive sells his shares after the lock-up period at lower than exercise price.

#### **4.3.2.4. Erste Group Other Compensation and Costs for Former Executives**

According to the annual report 2007, the item “other compensation” includes pension fund contributions and various non-cash compensation (see item “other”, table A-11). Relation of these costs to the base salary during 2004-2007 stayed relatively constant and amounted to about 29% in case of the chairman and to 23-25% in case of the other executives. Severance

payments for the members who retired during this period were also included in the category “other compensation”. In 2007 these were Mr. Ortner and Mr. Erasim, who received more than 1,3 and 1 million € correspondingly as severance payments (figures were determined by subtracting other compensation paid in the previous year from other compensation paid in 2007).

Besides, there have been company expenses due to compensation to the former members of the management board or their surviving dependants, averaging in the years 2002-2007 to 635.000 € per annum. This is summarized in the figure A-15. However, no accompanying information on details could be determined: it is not clear how many former board members on which basis were entitled to receive this compensation, neither when they have retired and how many years payouts will continue to last.

#### **4.4. Chapter Summary**

This chapter was exclusively dedicated to the managers’ remuneration and disclosure issues in Austria. First I gave an overview on existing legislation, consequential requirements, as well as general recommendations of the legislator with regard to managerial compensations and transparency.

Further, I presented the Austrian managers’ remuneration developments during the last few decades, based on the information provided by WdF. Specifically, I have pointed out main driving factors behind compensation, which have a strong correlation with overall payment sizes. In addition, increasing importance of performance-related compensation was shown and the main performance measures were mentioned.

Restricting the term “manager” to the managers of the listed companies in Austria, I have founded significantly higher average management compensation levels in ATX-companies compared to Austrian managers in general. Also the growth rate of directors’ remuneration of the publicly traded companies was considerably higher in the last several years. I have discussed possible explanations and factors, which have probably accounted for such developments, as well as composition issues of the compensation of ATX-managers with its overwhelming variable part.

In this respect I have compared the compensation development relative to their stock performance of the five ATX-companies, which reward their managers with the highest average compensation. The managerial compensation in all but one company showed to be highly correlated with stock price, at least in the last few years. In addition, I have looked into the annual reports of the 10 listed companies with highest market capitalization and found out

that 5 out of 10 companies do disclose compositions of the individual remuneration of their managers.

For the more detailed assessment of the remuneration and disclosure policy I have selected two representative companies with the largest stake in ATX-index: OMV AG and Erste Group. Both companies have developed very high overall corporate governance standards, among other things also with regard to executive pay and its transparency. At the same time, OMV AG seemed to have more stock price driven compensation attribute, whereas Erste Group implemented a performance-related bonus system, which is rather based on other than stock price factors.

Finally, separate components of executives' compensation and overall remuneration policy of both companies were discussed and assessed in detail paying special attention on disclosure matters.

## 5. Summary and Conclusions

---

During the composition of my thesis major changes and developments in the world economy took place driven by the global financial crisis 2008 and its consequences, which became the most prominent topic in business related media in the period of September to October 2008. The first culmination was the announcement of Lehman Brothers bankruptcy on September 14, 2008, followed by extreme instability of the global stock markets and subsequent failures, mergers and nationalizations of many financial giants worldwide.

In this respect, many blame among other things poor corporate governance systems and lack of appropriate supervision of the companies in general. In this course, some authors particularly point out how incentive compensation plans could have contributed to such a devastating outcome. For instance, Berrone holds stock options in combination with “golden parachutes” responsible for managers taking too much risk and pushing short-term results in their reports, hence harming shareholders in long-term perspective and destroying the company value (Berrone, 2008). Such attitude may not last forever and at some point the bubble collapses, as it happened in 2008.

From my point of view, the current ongoing crisis will have a huge impact on managerial compensations worldwide. Main impact will most probably imply increased transparency and reduced total compensation amounts. The increasing public attention and economic pressure will force companies to increase their disclosure levels on managerial compensation and its clarity. Some experts predict that compensation plans will become rather simple and straightforward with only two phased incentive components: cash bonuses linked to performance + full value shares and no stock options. Simplicity, fairness in pay and clarity for shareholders are the main criteria for the executive compensation contracts in the future (CorporateBoardMember, 2009). Also base salaries will be reduced in many cases. This, however, will affect in the first place the managers of companies which receive State aid. Using the example of the President of the U.S. Obama, also European politicians are thinking about adopting of the similar law on limitation of managerial compensation at some maximum level for the directors of the companies that participate in the national bailout programs. Nevertheless, there is still no common opinion regarding the size of such limitation. The Austrian Green Party is proposing to limit base salary of such managers by 285.000 EUR, the annual salary size of the Austrian Chancellor (derStandard, 15 February 2009). But, there are no explanatory underpinnings for the size of the limit. Though, some limitation at around 250.000-400.000 EUR will most probably be adopted soon. And this will definitely affect also

other companies, who have no need for the governmental loan but have to cope with the economic difficulties.

Interestingly, discussions and criticism of managerial remuneration attracts much more attention in single extreme examples and public opinion is very often influenced by individual black sheep, letting people to conclude about the entirety of the listed companies based on that matter. Usually, underlying incentives and their possible impact on decision making process in that given situation are omitted.

Originally, incentive contracts arose as a countermeasure against the principal-agent problem and were thought to align interests of shareholders and managers. Different methods were developed and some of incentive forms become accepted by the majority of companies. Stock option plans belonged to popular equity-based compensation methods and in the 1990s most of the publicly traded corporations in USA were proud to use stock options for rewarding their top-executives. Resulting annual payouts of tens of millions, in some cases of hundreds of millions U.S. dollars provoked hot discussions on the executive pay issue. The main criticism was that the share options tended to be not a very effective incentive for managers, as the stock price does not necessarily reflect managerial performance and some companies began moving away from stock option schemes, at least from their original form: already in 2003 Microsoft announced to abandon stock option grants completely and to implement restricted stock grants instead (NYTimes, 9 July 2003); later also IBM cut off option grants followed by General Electric revising its option program (Choe and Yin, 2006).

However, when talking about these and other similar cases it is important to keep in mind that it is not just about granting or not granting stock options, but it is rather about a comprehensive remuneration policy, which includes many other interdependent components and may represent a powerful lever for stimulating managers. Though these stimuli can become a double-edged sword and let individual executives, who strive after their own wealth maximization (as many other human beings do), act against interests of shareholders and society as a whole. Thus, when designing compensation schemes for the listed company one should be also concerned with a question of what other perverse incentives may be awoken by this or that provision for a manager driven by greed.

In this regard I would like to cite a statement of Heinrich Treichl, one of the most successful bankers in Austria, which he made during a recent interview: "... greed is a part of human nature. It is one of our main drivers. Without greed we won't even reproduce ourselves" (manager-magazin.de, 11.07.2008). Further he argues that creating an appropriate framework should be set as a primary target and not fighting the greediness itself. This simple, but

fundamental approach should be considered when designing the remuneration policy for managers, as well as for other employees. Even so it cannot be expected that a well designed remuneration framework will become a panacea for good performance and value creation. There are many other critical factors, which should be also involved in consideration. The supervisory board composition and independency of directors, shareholder-structure and impact of block-holders, monitoring provisions, auditor, company's focus and spectrum of activities, as well as country specific issues are just some of these factors, which should be considered in connection with the problem of remuneration framework designing.

In this context, under remuneration framework I refer not only to a company's compensation policy, but also to legal framework for managerial compensations and transparency, established on the national and supranational levels. Such regulations have been a subject to continuous change and development over the last few decades. One of the most recent and crucial issues in the USA lies within a so-called "say on pay": the new white-house administration headed by the U.S. President Obama is going to introduce a new legislation on shareholders' votes on senior executive compensation as a part of securities law (Fortune, 14 November 2008). This will be an important step towards involving shareholders in decision making process and strengthening the shareholder activism, a trend observed in recent years.

This is a particularly sensible issue for the U.S., as publicly listed companies in the U.S. still have lots of small shareholders and those, who have more than 5% are considered to be large shareholders, whereas companies listed in continental Europe usually have only one or few large block-holders (banks and other institutions), controlling a considerable share of the company. Such institutional shareholders perform virtually a direct control over the management and influence remuneration schemes through supervisory board members, appointed by them. This could also be another explanation, why managers in Europe have significantly lower compensation levels compared to their colleagues in the U.S.

With my thesis I made an attempt to look into a subject of the managerial remuneration from theoretical point of view, followed by an assessment of the situation in Austria with focus on two distinguished companies: OMV AG and Erste Group. My findings show, that both companies have already reached high standards of corporate governance and disclosure. Large compensation paid to their executives in comparison to other Austrian companies can be partially justified by their strong position on an international level, as well as through implementation of the performance-related compensation schemes, which led to success. But these measures and methods differ in each company significantly.



Concerning individual compensation components I was able to determine a consistency with my theoretical findings with regard to base salary component; however with regard to performance-related annual bonuses I was not able to confirm or reject such consistency due to the disclosure shortage on variable compensation and its formation. Also no direct impact of the main performance measures on variable bonus size in the short run was determined, though companies continued to perform good or very good in the long run.

The only long-term performance-related compensation was paid in form of stock options, though amounts and schemes in the both selected companies proved to have a grave difference. OMV AG implements rather classical, and consequently more questionable, stock option plans which entitled executives to huge payments compared to their base salary. Whereas Erste Group applies a modified method of the stock option grants with one year holding period and various other constraints, which improve stock options' incentive capabilities in long run and bear some qualities of the restricted stock. However, considerably lower payouts may be expected from exercising such options compared to OMV AG.

On the example of OMV AG and Erste Group I have seen how different remuneration approaches and disclosure policies can be applied successfully in different companies. In spite of the great success, applying these models in the other Austrian or international listed companies will not necessarily mean the same success and may bring completely different outcome. There are so many factors and circumstances, which should be considered for every single case, that only general and abstract suggestions on remuneration issues may be given, without specifying any details. Hence, it is also not possible to create a general framework for compensation assessment and each case should be considered individually situation dependent. In this context, my final conclusion may be comprised in the following statement: *"The appraisal of the remuneration policy of the company should be carried out situation dependent and may not be successfully performed on general basis".*

## A. Appendix

A-1: Performance of the ATX-index and selected ATX-stocks in 2005-2007

**ATX**  
099998 / AT0000999982 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**OMV AG**  
074305 / AT0000743059 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**ERSTE GROUP BANK AG**  
065201 / AT0000652011 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**TELEKOM AUSTRIA AG**  
072000 / AT0000720008 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**VERBUNDGESELLSCHAFT AG KAT. A**  
074640 / AT0000746409 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**VOESTALPINE AG**  
093750 / AT0000937503 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**VIENNA INSURANCE GROUP**

090850 / AT0000908504 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**RAIFFEISEN INT. BANK-HLDG AG**

B00081 / AT0000606306 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**INTERCELL AG**

061260 / AT0000612601 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**WIENERBERGER AG**

083170 / AT0000831706 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**OESTERR. POST AG**

APOST / AT0000APOST4 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

**ANDRITZ AG**

073000 / AT0000730007 / Vienna Stock Exchange



© 2008 Interactive Data Managed Solutions AG, all rights reserved and powered by Interactive Data Managed Solutions

*A-2: OMV AG executives' individual remuneration in 2006-2007, stock options not included*

Remuneration of the Executive Board						EUR 1,000
2007	Auli	Davies	Langanger	Roiss	Ruttenstorfer	Total
Fixed	350	525	460	530	600	2,465
Variable	68	1,105	1,105	1,273	1,442	4,993
Pension fund contributions	72	208	129	99	145	653
Benefits in kind (company car, accident insurance) and reimbursed expenses	8	9	8	8	8	42
Total	498	1,847	1,702	1,910	2,195	8,153

Remuneration of the Executive Board						EUR 1,000
2006	Davies	Langanger	Roiss	Ruttenstorfer	Total	
Fixed	525	460	530	600	2,115	
Variable	1,067	1,067	1,227	1,387	4,748	
Pension fund contributions	208	129	99	145	581	
Benefits in kind (company car, accident insurance) and reimbursed expenses	9	8	8	8	33	
Total	1,809	1,664	1,864	2,140	7,477	

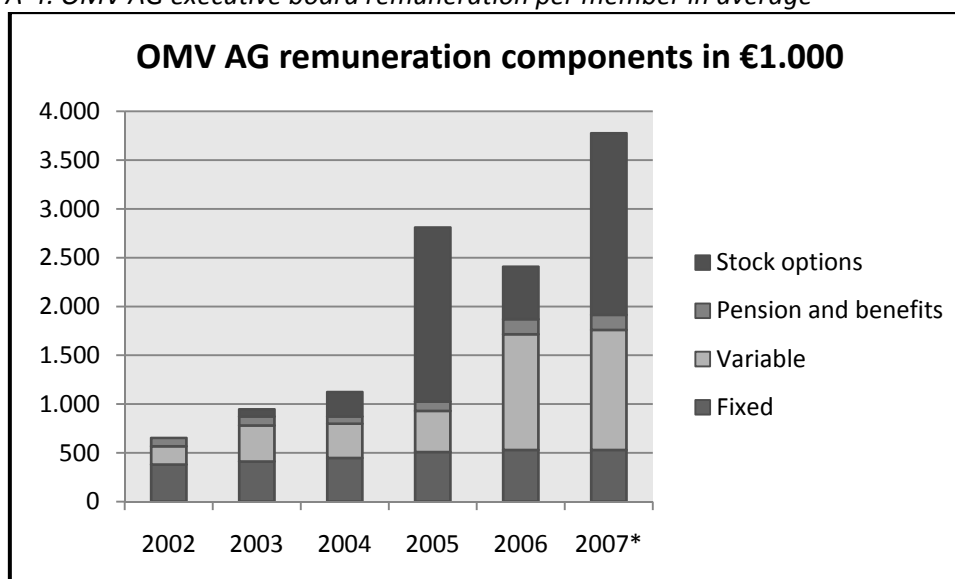
Source: OMV Annual Report 2007

*A-3: OMV AG executive board total remuneration development 2002-2007*

In Euro 1.000	2002	2003	2004	2005	2006	2007
Fixed (1)	1.521	1.644	1.786	2.029	2.115	2.465
Variable (2)	745	1.479	1.405	1.691	4.748	4.993
Pension fund contributions and other benefits (3)	343	363	294	381	614	695
Costs of the exercise of stock options (4)	0	296	1.007	7.132	2.155	7.447
<b>Total remuneration</b>	<b>2.609</b>	<b>3.782</b>	<b>4.492</b>	<b>11.233</b>	<b>9.632</b>	<b>15.600</b>
Perf. related compensation ratio [(2)+(4)]/(1)	49%	108%	135%	435%	326%	505%
Other compensation / base salary (3)/(1)	23%	22%	16%	19%	29%	28%

Based on own calculations, figures are taken from Annual Reports 2002-2007

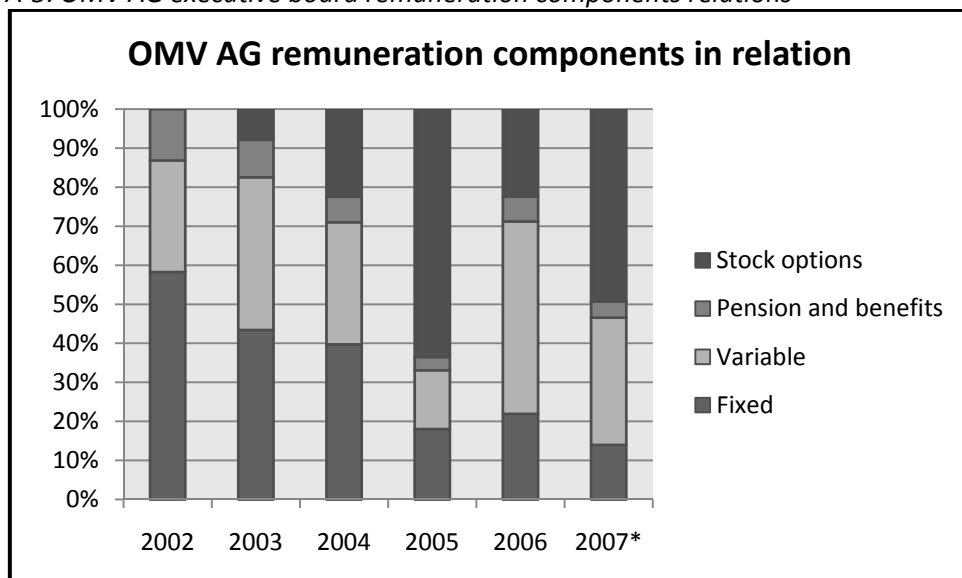
*A-4: OMV AG executive board remuneration per member in average*



\*Excluding the new board member Mr. Auli.

Based on own calculations, figures are taken from Annual Reports 2002-2007

A-5: OMV AG executive board remuneration components relations



\*Excluding the new board member Mr. Auli.

Based on own calculations, figures are taken from Annual Reports 2002-2007

A-6: OMV AG most important performance measures and ratios in 2001-2007

in EUR 1.000	2001	2002	2003	2004	2005	2006	2007
<b>Sales</b>	7.736,00	7.079,00	7.644,00	9.829,00	15.580,00	18.970,00	20.042,00
Δ		-8%	8%	29%	59%	22%	6%
<b>EBIT</b>	610,00	495,00	644,00	975,00	1.958,00	2.061,00	2.184,00
Δ		-19%	30%	51%	101%	5%	6%
<b>Net Income</b>	381,00	322,00	393,00	642,00	1.256,00	1.383,00	1.579,00
Δ		-15%	22%	63%	96%	10%	14%
<b>Balance sheet total</b>	5.772,00	6.149,00	7.517,00	13.236,00	15.451,00	17.804,00	21.250,00
Δ		7%	22%	76%	17%	15%	19%
<b>NOPAT</b>	410,00	345,00	435,00	718,00	1.492,00	1.682,00	1.869,00
Δ		-16%	26%	65%	108%	13%	11%
<b>ROACE in %</b>	14%	11%	12%	15%	20%	18%	16%
<b>ROE in %</b>	18%	14%	15%	19%	22%	20%	19%
<b>DPS in EUR</b>	0,43	0,35	0,4	0,44	0,9	1,05	1,25

Based on Annual Reports 2001-2007

A-7: OMV AG Stock options plan 2000-2007

	2000	2001	2002	2003	2004	2005	2006*	2007*
Plan begin	01.07.2000	01.07.2001	01.07.2002	01.09.2003	01.09.2004	01.09.2005	01.09.2006	01.09.2007
Plan expiration	30.06.2005	30.06.2006	30.06.2007	31.08.2008	31.08.2011	31.08.2012	31.08.2013	31.08.2014
Vesting period	2 years	2 years	2 years	2 years	2 years	2 years	2 years	2 years
Options granted	111.300	84.000	223.100	336.000	238.800	191.200	99.360	98.400
Exercise price €	9,143	10,392	10,090	10,404	16,368	34,700	45,190	47,850
Threshold price €	10,514	11,951	11,604	11,965	18,823	39,905	51,969	55,028
Options exercised	none	none	none**	111.300	161.900	229.200	72.000	197.850
Average exercise price €	-	-	-	9,143	10,247	10,205	12,889	11,304
Mrkt price at exercise €	-	-	-	11,802	16,467	41,322	42,820	48,944
Value to executives €	-	-	-	296.000	1.007.000	7.132.000	2.155.000	7.447.000
Vested options remaining after exercise			111.300	84.000	145.200	252.000	418.800	412.150
* Excluding the new board member Mr. Auli								
** Threshold price was not reached, hence no options could be exercised								
Stock amounts and prices in 2000-2004 were adjusted to the figures in 2005-2007								

Own illustration based on Annual reports 2002-2007

*A-8: OMV AG Stock options granted and exercised 2000-2007 by the executive board members*

	2003	2004	2005	2006	2007	Total granted	Exercise price	Remaining unexercised
2000	111.300					111.300	9,143	0
2001		84.000				84.000	10,392	0
2002		77.900	145.200			223.100	10,09	0
2003			84.000	42.000	168.000	336.000	10,404	42000
2004				30.000	29.850	238.800	16,368	178950
2005						191.200	34,7	191200
Total exercised	111.300	161.900	229.200	72.000	197.850			
Average exercise price	9,143	10,247	10,205	12,889	11,304			
Mrkt price on exercise	11,80248	16,46689	41,32193	42,81956	48,94363			
Payout value in €	296.000	1.007.000	7.132.000	2.155.000	7.447.000			

*Own illustration based on Annual reports 2002-2007*

*(Included are only options with expired vesting period by the 31.12.2007)*

*A-9: OMV AG Stock options individual distribution to the executive board members*

		2000	2001	2002	2003	2004	2005	2006	2007
<b>Davies</b>	granted	0	0	59.500	84.000	59.700	47.800	24.840	24.600
	exercised			0	0	0	59.500	0	84.000
	Vested options remaining				0	59.500	84.000	143.700	107.500
<b>Langanger</b>	granted	15.900	0	44.600	84.000	59.700	47.800	24.840	24.600
	exercised			0	15.900	44.600	0	0	71.850
	Vested options remaining				0	0	84.000	143.700	119.650
<b>Roiss</b>	granted	47.700	42.000	59.500	84.000	59.700	47.800	24.840	24.600
	exercised			0	47.700	75.300	110.200	30.000	0
	remaining				42.000	26.200	0	29.700	77.500
<b>Ruttenstorfer</b>	granted	47.700	42.000	59.500	84.000	59.700	47.800	24.840	24.600
	exercised				47.700	42.000	59.500	42.000	42.000
	Vested options remaining				42.000	59.500	84.000	101.700	107.500

*Own illustration based on Annual reports 2002-2007*

A-10: OMV AG stock performance relative to ATX Index in 2003-2008



A-11: Erste Group remuneration breakdown of the 5 highest paid executives in 2004-2007

	in 1.000 €	2004	2005	2006	2007
<b>Andreas Treichl</b>	<b>Total remuneration</b>	<b>4.545</b>	<b>2.911</b>	<b>2.968</b>	<b>4.420</b>
Chairman	thereof salary	1.200	1.200	1.245	1.239
07/1997 - 06/2012	bonus	3.000	1.357	1.357	2.820
	other	345	354	366	361
<b>Elisabeth Bleyleben-Koren</b>	<b>Total remuneration</b>	<b>1.855</b>	<b>2.142</b>	<b>2.186</b>	<b>2.050</b>
Deputy Chairwoman	thereof salary	900	900	934	831
05/1999 - 06/2012	bonus	750	1.028	1.030	1.023
	other	205	214	222	196
<b>Franz Hochstrasser</b>	<b>Total remuneration</b>	<b>1.547</b>	<b>1.806</b>	<b>1.841</b>	<b>1.523</b>
01/1999 - 06/2012	thereof salary	750	750	778	702
	bonus	625	875	875	656
	other	172	181	188	165
<b>Reinhard Ortner</b>	<b>Total remuneration</b>	<b>1.547</b>	<b>1.787</b>	<b>1.817</b>	<b>2.945</b>
07/1984 - 06/2007	thereof salary	750	750	778	399
	bonus	625	854	850	1.002
	other	172	183	189	1.544
<b>Erwin Erasim</b>	<b>Total remuneration</b>	<b>1.037</b>	<b>1.206</b>	<b>1.233</b>	<b>1.896</b>
01/2001 - 06/2007	thereof salary	500	500	519	267
	bonus	420	580	583	438
	other	117	126	131	1.191

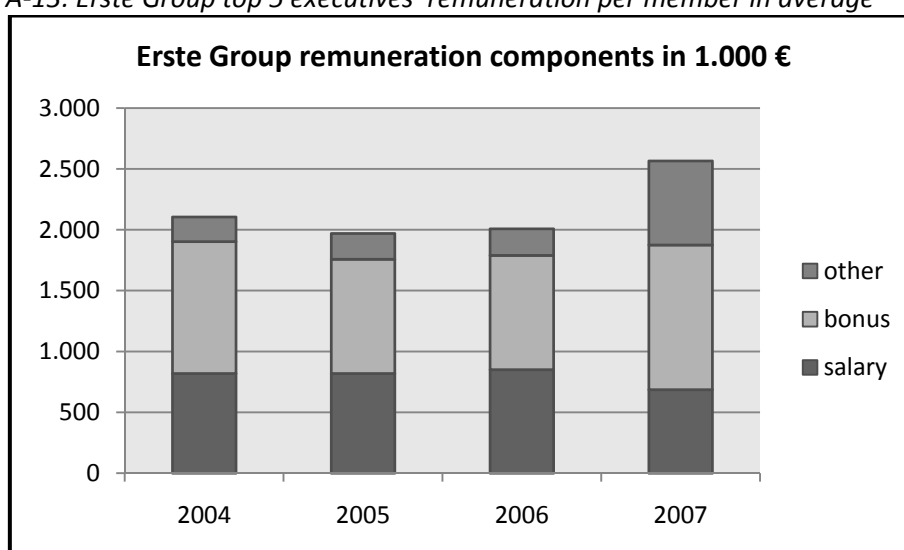
Own illustration, figures are taken from Annual Reports 2004-2007

A-12: Erste Group total remuneration of the other members of the management board

<b>Newly appointed board members:</b>	<b>Appointment</b>	<b>2006</b>	<b>2007</b>	
Bernhard Spalt	11/2006 - 06/2012	87	808	
Peter Bosek	07/2007 - 06/2012		248	
Herbert Juranek	07/2007 - 06/2012		327	
Johannes Kinsky	07/2007 - 06/2012		321	
Peter Kisbenedek	07/2007 - 06/2012		381	
Thomas Uher	07/2007 - 06/2012		273	
<b>Former board members:</b>	<b>Appointment</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Christian Coreth	07/2004 - 10/2006	248	1.031	1.087
André Horovitz	01/2003 - 06/2004	893		

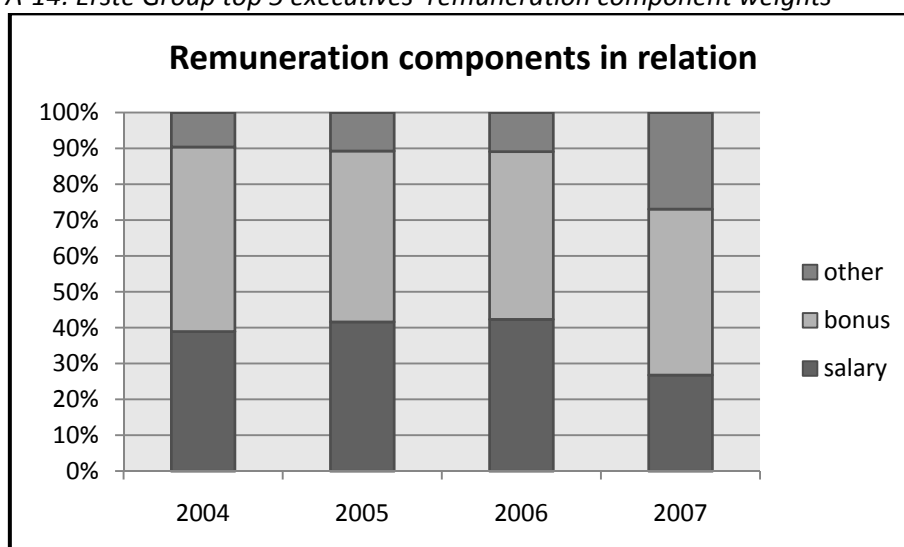
Own illustration, figures are taken from Annual Reports 2004-2007

A-13: Erste Group top 5 executives' remuneration per member in average



Based on own calculations, figures are taken from Annual Reports 2004-2007

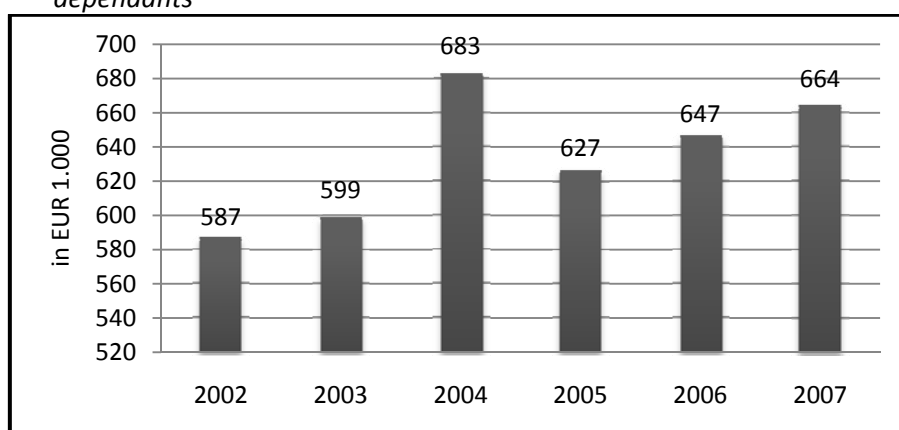
A-14: Erste Group top 5 executives' remuneration component weights



Based on own calculations, figures are taken from Annual Reports 2004-2007

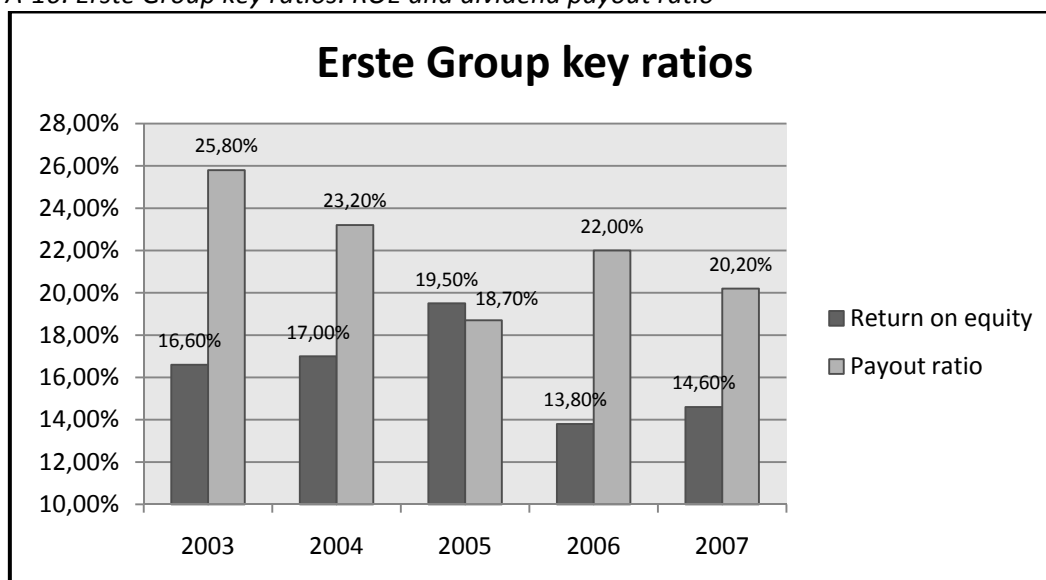


A-15: Erste Group payments to former members of the management board or their surviving dependants



Source: Annual Reports 2003-2007

A-16: Erste Group key ratios: ROE and dividend payout ratio



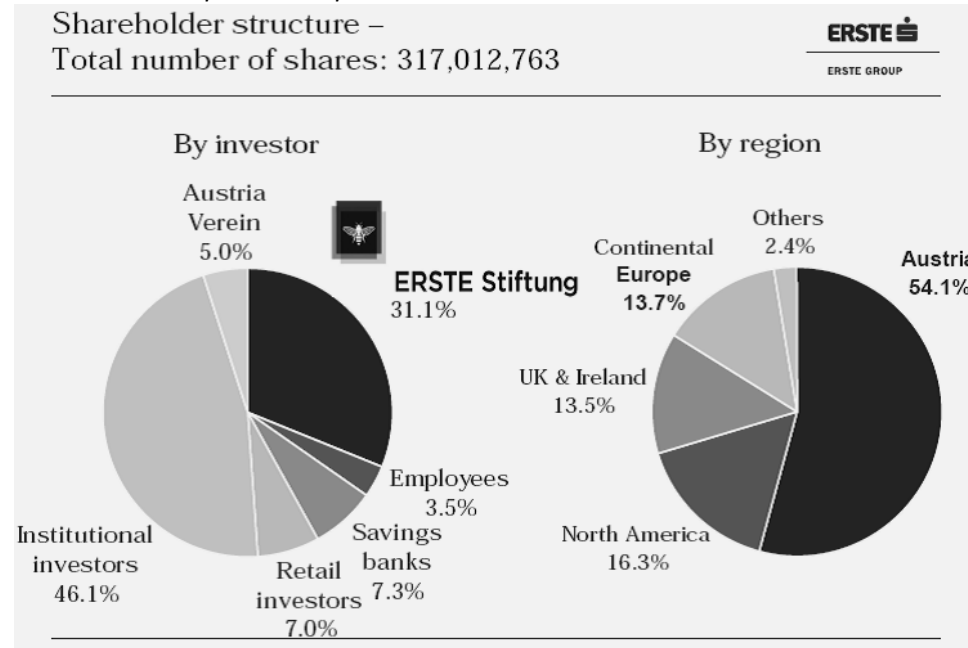
Source: Annual Report 2007

A-17: Erste Group most important performance measures and ratios in 2003-2007

in EUR 1.000.000	2003	2004	2005	2006	2007
Total assets	128.575	139.812	152.681	181.703	200.519
Δ		+8,74%	+9,20%	+19,01%	+10,36%
Net income	3.583,4	3.795,7	4.051,0	4.635,2	5.803,7
Δ		+5,92%	+6,73%	+14,42%	+25,21%
Net profit after minorities	353	521	717	932	1.175
Δ		+47,41%	+37,62%	+30,07%	+26,01%
DPS in €	0,38	0,5	0,55	0,65	0,75
Δ		+31,58%	+10,00%	+18,18%	+15,38%
EPS in €	1,83	2,18	2,98	3,14	3,92
Δ		+19,13%	+36,70%	+5,37%	+24,84%
Return on equity	16,60%	17,00%	19,50%	13,80%	14,60%
Δ		+2,41%	+14,71%	-29,23%	+5,80%
Dividend payout ratio	25,80%	23,20%	18,70%	22,00%	20,20%
Δ		-10,08%	-19,40%	+17,65%	-8,18%

Based on the Annual Report for 2007

A-18: Erste Group ownership structure



Source: [www.erstegroup.com](http://www.erstegroup.com), stand 09 October 2008

A-19: Ownership of the shares by the top five highest ranked board members of Erste Group

		2003	2004	2005	2006	2007
<b>Andreas Treichl</b>	Total per 31.12.	80.840	104.040	120.040	123.440	167.440
	Additions		32.400	16.000	3.400	47.000
	Disposals		9.200	0	0	3.000
	(Thereof additions from exercised options)		32.000	16.000	3.000	0
<b>Elisabeth Bleyleben-Koren</b>	Total per 31.12.	8.840	24.400	25.600	25.600	22.800
	Additions		28.000	20.000	0	3.200
	Disposals		12.440	18.800	0	6.000
	(Thereof additions from exercised options)		28.000	20.000	0	0
<b>Franz Hochstrasser</b>	Total per 31.12.	12.728	28.256	44.256	47.256	37.256
	Additions		24.000	24.000	3.000	0
	Disposals		8.472	8.000	0	10.000
	(Thereof additions from exercised options)		24.000	24.000	3.000	0
<b>Reinhard Ortner</b>	Total per 31.12.	73.400	105.400	121.400	125.600	0
	Additions		32.000	16.000	4.200	200
	Disposals		0	0	0	125.800 *)
	(Thereof additions from exercised options)		32.000	16.000	3.000	0
<b>Erwin Erasim</b>	Total per 31.12.	400	20.800	20.716	13.916	0
	Additions		24.000	24.000	3.200	200
	Disposals		3.600	24.084	10.000	14.116 *)
	(Thereof additions from exercised options)		24.000	24.000	3.000	0

\*) Stock held by the executives, who left during 2007, was classified in disposals category

A-20: Erste Group stock performance compared with ATX Index in 1999-2008

<b>ATX</b>	<b>1,812.54</b>	<b>+3.52%</b>	Hoch: 1,812.54
099998 / AT0000999982 / Vienna Stock Exchange	01/02. 17:36:39	+61.71	Tief: 1,752.54



© 1996-2008 Interactive Data Managed Solutions AG, all rights reserved.  
Implemented and powered by Interactive Data Managed Solutions AG.

## B. References

---

### Books

- Armstrong, M. & Murlis, H. (2007) *Reward Management - A Handbook of Remuneration Strategy and Practice*, London and Philadelphia, (5th edition) Hay Group.
- Bebchuk, L. A. & Fried, J. M. (2006) *Pay without performance - the unfulfilled promise of executive compensation*, Cambridge, Mass., (First Harvard University Press paperback edition) Harvard University Press. XII, 278 S.
- Brealey, R. A., Myers, S. C. & Allen, F. (2008) *Principles of Corporate Finance*, (9. ed., internat. ed.) McGraw-Hill. 327-345
- Ehrenberg, R. G. S., Robert S. (2008) *Modern Labor Economics - Theory and Public Policy*, Boston, San Francisco (et al.), (10th Edition: Pearson International Edition) Pearson Addison Wesley. 650
- Ellig, B. R. (2007) *The Complete Guide to Executive Compensation*, New York, (Fully Revised and Expanded Edition) The McGraw-Hill Companies. XI, 793 S.
- Frederikslust, R. A. I. v., Ang, J. S. & Sudarsanam, S. P. (2008) *Corporate Governance and Corporate Finance - A European perspective*, London, Routledge. XXI, 757 S.
- Krames, J. A. (2003) *What the best CEOs know - 7 exceptional leaders and their lessons for transforming any business*, New York, London (et al.), (1. ed.) McGraw-Hill. VI, 250 S.
- Lipman, F. D. & Hall, S. E. (2008) *Executive compensation best practices*, Hoboken, NJ, John Wiley & Sons. XVII, 318 S.

### Journal Papers and Newspaper Articles

- Abowd, J. M. & Kaplan, D. S. (1999) Executive Compensation: six questions that need answering. Retrieved September 2008, from *NBER Working Paper Series*.  
<http://ssrn.com/abstract=165134>
- Armstrong, P. (February 2008) The EU approach to Corporate Governance - Essentials and Recent Developments. Retrieved December 2008, from *Global Corporate Governance Forum, International Finance Corporation*.  
[http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/EU+Approach+to+CG/\\$FILE/IFC\\_EUApproach\\_Final.pdf](http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/EU+Approach+to+CG/$FILE/IFC_EUApproach_Final.pdf)
- Bebchuk, L. A. & Fried, J. M. (2004) Stealth Compensation Via Retirement Benefits. Retrieved October 2008, from *NBER Working Paper Series*. <http://ssrn.com/abstract=590730>
- Berrone, P. (2008) Current Global Financial Crisis: An Incentive Problem. Retrieved January 2009, from *IESE Business School - University of Navarra, Occasional Papers*, 7.  
<http://www.iese.edu/research/pdfs/OP-0158-E.pdf>
- Choe, C. & Yin, X. (2006) Should Executive Stock Options Be Abandoned? Retrieved December 2008, from *Australian Journal of Management*, Vol. 31, No. 2.  
[http://www.agsm.edu.au/eajm/0612/pdf/Paper\\_1\\_Choe\\_Yin\\_December\\_2006.pdf](http://www.agsm.edu.au/eajm/0612/pdf/Paper_1_Choe_Yin_December_2006.pdf)
- Coombes, P. & Wong, S. C. Y. (2004) Why Codes of Governance Work. Retrieved December 2008, from *Social Science Research Network, The McKinsey Quarterly*, No. 2, 2004.  
<http://ssrn.com/abstract=897422>

- Denis, D. K. (2001) Twenty-five years of corporate governance research . . . and counting. Retrieved from *Review of Financial Economics*, Volume 10, Issue 3, Pages 191-212  
[www.sciencedirect.com](http://www.sciencedirect.com): doi:10.1016/S1058-3300(01)00037-4
- Guay, W. R., Core, J. E. & Larcker, D. F. (2002) Executive Equity Compensation and Incentives: A Survey. Retrieved October 2008, from *Social Science Research Network*.  
<http://ssrn.com/abstract=276425>
- Hermalin, B. E. & Weisbach, M. S. (2007) Transparency and Corporate Governance. Retrieved November 2008, from *NBER Working Paper Series*, 28.  
<http://www.nber.org/papers/w12875>
- Jensen, M. C. (1993) The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems. Retrieved February 2009, from *Journal of Finance*, 48, pp. 831-880.  
<http://ssrn.com/abstract=93988>
- Jensen, M. C. & Meckling, W. H. (1976) Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. Retrieved May 2007, from *Social Science Research Network*.  
<http://ssrn.com/abstract=94043>
- Lambert, R. A. & Larcker, D. F. (2004) Stock Options, Restricted Stock, and Incentives. Retrieved November 2008, from *Social Science Research Network*.  
<http://ssrn.com/abstract=527822>
- Murphy, K. J. (1999) Executive Compensation. Retrieved April 2007, from *Social Science Research Network*. <http://ssrn.com/abstract=163914>
- Rose, N. L. & Wolfram, C. (2000) Has the "Million-Dollar Cap" Affected CEO Pay? Retrieved October 2008, from *American Economic Association in collaboration with JSTOR*.  
<http://www.jstor.org/stable/117220>
- Singh, R. (2006a) Board Independence and the Design of Executive Compensation. Retrieved November 2008, from *Social Science Research Network*, 28.  
<http://ssrn.com/abstract=673741>
- Singh, R. (2006b) Incentive Compensation and the Quality of Disclosure. Retrieved November 2008, from *Social Science Research Network*, 39. <http://ssrn.com/abstract=574281>
- Smith, A. (1776) An Inquiry into the Nature And Causes of the Wealth of Nations. Retrieved October 2008, from *Adam Smith Institute*. <http://www.adamsmith.org/smith/won-b5-c1-article-1-ss3.htm>

### **Institutional Web Resources**

- Austrian Code of Corporate Governance (version: June 2007). Retrieved August 2008, from *Austrian Working Group for Corporate Governance*: <http://www.corporate-governance.at/>
- AK (2007) AK-Untersuchung: 2007 war ein gutes Jahr für die Manager. Retrieved December 2008, from *Arbeiterkammer-Studie*:  
[http://www.arbeiterkammer.at/bilder/d62/AK\\_Untersuchung\\_Managergehaelter.pdf](http://www.arbeiterkammer.at/bilder/d62/AK_Untersuchung_Managergehaelter.pdf)
- AK (2008) AK-Studie: Trotz Börsenkrise erneut Rekordgagen für ATX-Manager. Retrieved December 2008, from *Arbeiterkammer-Studie*:  
<http://www.arbeiterkammer.at/pictures/d69/ATXStudie2008.pdf>

- CorporateBoardMember (2009) Director Compensation: Past, Present, and Future (video: discussion by Robert A. Romanchek). Retrieved February 2009, from BOARDMEMBER.com: <http://www.boardmember.com/boardroom-channel/index.cfm?c=699&i=3311&topic=5>
- derStandard (15 February 2009) Manager sollen mehr Strenge spüren. Retrieved February 2009, from *derStandard.at*: <http://derstandard.at/?id=1234507088953>
- derStandard (30 May 2008) Heimische Manager im Gehalts-Check. Retrieved July 2008, from *derStandard.at*, Ostermann, G.: <http://derstandard.at/?url=/?id=3356187>
- Diepresse (3 October 2008) Europa sagt der Manager-Gier den Kampf an. Retrieved October 2008, from *diepresse.com*: <http://diepresse.com/home/politik/eu/419498/index.do?from=suche.intern.portal>
- Diepresse (30.10.2008) Erste Bank braucht Geld vom Staat: 2,7 Milliarden Euro Eigenkapital. Retrieved December 2008, from *diepresse.com*: <http://diepresse.com/home/wirtschaft/economist/426826/index.do>
- ECGI (October 2008) Directors' Remuneration in Listed Companies. Austria. Retrieved December 2008, from *ECGI - European Corporate Governance Institute*, Kalss, S.: [http://www.ecgi.org/remuneration/questionnaire/austria\\_update\\_2008.pdf](http://www.ecgi.org/remuneration/questionnaire/austria_update_2008.pdf)
- EU-Commission (13 July 2007) Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration. Retrieved December 2008, from *European Commission Web-site*, Brussels: [http://ec.europa.eu/internal\\_market/company/docs/directors-remun/sec20071022\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/directors-remun/sec20071022_en.pdf)
- EU-Commission (29 December 2004) Commission Recommendation - fostering an appropriate regime for the remuneration of directors of listed companies. Retrieved November 2008, from *Official Journal of the European Union*, Brussels: [http://ec.europa.eu/internal\\_market/company/directors-remun/index\\_en.htm](http://ec.europa.eu/internal_market/company/directors-remun/index_en.htm)
- EU-Press-release (6 October 2004) Directors' pay – Commission sets out guidance on disclosure and shareholder control. Retrieved November 2008, from *Europa Press releases RAPID*, Brussels: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/1183&format=HTML&aged=0&language=EN&guiLanguage=en>
- EU-Press-release (19 July 2007) Corporate governance: Commission reports on application of EU recommendations on directors' pay and independence. Retrieved November 2008, from *Europa Press releases RAPID*, Brussels: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1147&format=HTML&aged=0&language=EN>
- Format (14.4.2005) Treichl Rekordgage löst eine Debatte über Managergehälter aus: Der Erste-Bank-Chef im Interview. Retrieved January 2009, from *Format.at*: <http://www.format.at/articles/0515/520/109743/treichl-rekordgage-debatte-managergehaelter>
- Fortune (14 November 2008) Investors join Obama on CEO pay. Retrieved December 2008, from *Fortune Magazine*: [http://money.cnn.com/2008/11/13/news/companies/CEO\\_pay\\_Obama.siklos.fortune](http://money.cnn.com/2008/11/13/news/companies/CEO_pay_Obama.siklos.fortune)

- Kurier (31 May 2008) Manager: Druck steigt, Einkommen nicht. Retrieved from *Kurier Karrieren, hardcopy*
- manager-magazin.de (11.07.2008) Porträt: Die fabelhafte Welt der Treichls. Retrieved January 2009, from *Manager Magazin*: <http://www.manager-magazin.de/magazin/artikel/0,2828,549658,00.html>
- NewsDaily (04 February 2009) U.S. sets executive pay limits for bailout companies. Retrieved February 2009, from *The News Daily*: <http://www.newsdaily.com/stories/tre5125p4-us-obama/>
- NYTimes (9 July 2003) Microsoft Will Award Stock, Not Options. Retrieved January 2009, from *The New York Times*: <http://query.nytimes.com/gst/fullpage.html?res=9C01E4DB123DF93AA35754C0A9659C8B63>
- SEC (2008) The 21st Century Disclosure Initiative. Retrieved December 2008, from *U.S. Securities and Exchange Commission*: <http://www.sec.gov/spotlight/disclosureinitiative.shtml>
- Tagesspiegel (28 April 2008) Koalition streitet über das Gehalt der Manager. Retrieved 29.10.2008, from *Der Tagesspiegel - Wirtschaft, Riedel, D. & El-Sharif, Y.*: <http://www.tagesspiegel.de/wirtschaft/Managergehaelter;art271,2521368>
- WdF (May 2008) Wieviel Österreichs Manager verdienen. Retrieved 10 July 2008, from *E-mail Mag. Roland Graf - Studien-Auszug für Diplomarbeit: Die WdF-Einkommensstudie 2008*: <http://www.wdf.at/content/site/home/publikationen/studien/article/19.html>
- White, J. W. (2008) Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009. Retrieved December 2008, from *U.S. Securities and Exchange Commission*: <http://www.sec.gov/news/speech/2008/spch102108jww.htm>
- Wirtschaftsblatt (30.10.2008) Treichl lässt Bonus liegen, Gage bei 20 Prozent. Retrieved January 2009, from [www.wirtschaftsblatt.at](http://www.wirtschaftsblatt.at): <http://www.wirtschaftsblatt.at/home/boerse/bwien/348808/index.do>

## Other Web Resources

- Erste: (2002-2007) Erste Group Bank AG Annual Reports. Retrieved December 2008: [www.erstegroup.com](http://www.erstegroup.com)
- Investopedia: Camouflage Compensation. Retrieved September 2008: <http://www.investopedia.com/terms/c/camouflagecompensation.asp>
- Investopedia: Long-Term Incentive Plan - LTIP. Retrieved November 2008: [http://www.investopedia.com/terms/l/long\\_term\\_incentive-plan.asp](http://www.investopedia.com/terms/l/long_term_incentive-plan.asp)
- Investopedia: Severance Pay. Retrieved September 2008: <http://www.investopedia.com/terms/s/severancepay.asp>
- OMV: (2001-2007) OMV AG Annual Reports. Retrieved December 2008: [www.omv.com](http://www.omv.com)
- Wienerbörse: (2008) Vienna Stock Exchange. Retrieved 2008 continuously: [www.wienerborse.at](http://www.wienerborse.at)
- Wikipedia: Say on pay. Retrieved November 2008: [http://en.wikipedia.org/wiki/Say\\_on\\_pay](http://en.wikipedia.org/wiki/Say_on_pay)

## **Abstract**

---

The target of the thesis was to make an attempt to find out and to describe an optimal compensation strategy, which could be successfully applied by publicly listed companies. The origins of the compensation problem, different approaches and propositions regarding each single compensation component, as well as transparency issues were discussed in the theoretical part of the paper, particularly pointing out possible advantages and drawbacks. In the subsequent praxis-related part the focus was made on the Austrian managers and their compensations. For closer examination two representatives of the largest Austrian companies were selected (OMV AG and Erste Group) and an extensive analysis of the top-management compensation in relation to the annual performance development was conducted. The results showed how different remuneration approaches and disclosure policies could be applied successfully in different companies. There are so many factors and circumstances, which should be considered for every single case, that only general and abstract suggestions on compensation issues may be given. Hence, the appraisal of the remuneration policy of the company should be carried out situation dependent and may not be successfully performed on general basis, as it was initially pursued.



# JAVLON YULDASHEV

Geboren am 13.05.1983  
Staatsangehörigkeit: Usbekistan



## Ausbildung:

10/2006 – 03/2009	<b>Universität Wien Masterstudium IBW</b> International Management (1,6) + Corporate Finance (2,4)
01/2004 – 10/2004	<b>Berufsakademie Ravensburg</b> Austauschstudium: Marketing und Handel Stipendiat im Rahmen des Baden-Württemberg-Stipendiums
09/1999 – 07/2003	<b>Staatliche Wirtschaftsuniversität Taschkent, Usbekistan</b> Bachelor Abschluss BWL: ausgezeichneter Erfolg (1,1) DA-Thema: Regionale Wirtschaftsintegration in Zentralasien
09/2002 – 05/2003	<b>Goethe-Institut Taschkent, Usbekistan</b> Deutschkurs: Zentrale Mittelstufenprüfung
09/1997 – 06/1999	<b>Republikanische Wirtschaftsoberschule</b> bei der Staatlichen Wirtschaftsuniversität Taschkent Matura (1,3)

## Berufserfahrung:

seit 11/2008	<b>Raiffeisen International Bank-Holding AG, Wien</b> Werkstudent in Regional Office
06/2008 – 09/2008	<b>Raiffeisen International Bank-Holding AG, Wien</b> Praktikant in Regional Office, Projekt Greenfield Investment
01/2008 – 02/2008 08/2007 – 09/2007	<b>Henkel CEE GmbH, Wien</b> Praktikant im Bereich Regional Finance
11/2004 – 09/2006	<b>Botschaft der Republik Usbekistan, Wien</b> Referent, Administrativer Berater
03/2004 – 10/2004	<b>MP Merkel GmbH, Friedrichshafen</b> Praktikant im Rahmen des Austauschstudiums in Ravensburg
04/2003 – 05/2003	<b>Ministerium für außenwirtschaftliche Beziehungen, Investitionen und Handel der Republik Usbekistan</b> Praktikant in der hauptanalytischen Abteilung
07/2002 – 08/2002	<b>Siemens AG, Vertretung in Taschkent, Usbekistan</b> Praktikant in diversen Abteilungen

## Sprachkenntnisse

**Usbekisch** (Muttersprache), **Russisch** (Muttersprache)  
**Englisch** (Verhandlungssicher), **Deutsch** (Verhandlungssicher)