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GEOGRAPHICAL DIFFERENCES IN EXECUTIVE REMUNERATION POLICIES. AN EMPIRICAL ANALYSIS

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Many thanks to my Mom and Dad.

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Abstract

This research is aimed at analysing different aspects of executive remuneration. Particularly, both the Agency Theory and the Managerial Power Theory have been deeply depicted, highlighting both the differences and the similarities among the two hypotheses.

In brief, a first chapter is about the main remuneration packages elements: base salary, benefits – non-monetary perquisites, pension and severance, short-term incentive plans – annual bonuses settled mainly in cash, long-term incentive plans – equity-based agreements which incentivize the Management.

In a second chapter, this research demonstrates through a sample of five companies how and why members of the Board a Directors differently implement remuneration packages.

The companies chosen for the sample are all small listed companies obliged to disclose remuneration data in their Annual Reports. Moreover, they all operate in the Materials sector but in different countries: The United States, the United Kingdom, Italy, Brazil, and Japan. Indeed, this research aims at showing the geographical differences in executive remuneration policies among companies similar in size and running their businesses in the same field but located in countries where the economic, political and social framework differs.

Introduction

Nowadays, executives' remuneration is a contentious issue. Many reasons are at the very root of the rising interest in the matter.

Firstly, since compensation contracts may affect firm behaviour, performance and value (Edmans, Gabaix and Jenter, 2017) and shareholders are concerned about the company's performance, hiring, retaining and incentivising a high-performing Management has become crucial. Indeed, this research focuses on showing the relevance of well-designed remuneration packages in enhancing the correlation between pay and performance in an Agency Theory perspective, the so-called pay-performance sensitivity. The pay-performance sensitivity indicates whether an executive is properly compensated for the actions and decisions taken when running the business.

Many theorists have been analysing such topic over the time. While in the past, some have found out how executive compensation is linked to both firm size and profit, contemporary researchers have been concentrating on agency problems led to the separation between ownership and control in public companies. Indeed, once Jensen and Meckling (1976) have designed the Agency Theory major features, Coughlan and Schmidt (1985), Murphy (1985), Abowd (1990), Leonard (1990) have contributed to the development of the literature concerning the relationship between executives' remuneration and corporations' performance.

Furthermore, one of the most remarkable points in this research is the interdisciplinary approach to the issue. Although this research supports the Agency Theory explanation when it comes to demonstrating the relevance of incentivising remuneration packages in firm performance enhancement, this research does not neglect the contribution given to the topic by sociologists, business strategists, and organizational behaviour scholars. Eventually, since executive compensation is tied to the firm performance, this research has mentioned how executive compensation is also tied to investment projects implementation, debt or equity financing choices, diversification policies and changes in control. Indeed, managers' pay yields many points for reflection and hence has become a well-known debated topic.

A second reason which has contributed to the spread of the matter is the huge observable increase in pay levels. Although there are dissimilarities in the evolution of pay levels (Edmans, Gabaix and Jenter, 2017) among listed corporations, large corporations have recorded the largest increase in executives' compensation amounts. Indeed, both fixed and variable remuneration have raised.

Additionally, after the 2008-2009 Financial Crisis scandalous business failures, such as the Enron and Tyco ones, have led Corporate Governance issues to be in the glare of the media spotlight. Indeed, business failures damage a large variety of stakeholders, from investors to families. As a matter of fact, the transparency and the accountability of information disclosure is crucial to avoid other scandals. Since listed companies are required to disclose remuneration data and Corporate Governance policies, investigations on executive compensation are becoming more and more detailed. In this framework, governments and regulators worldwide are promoting laws which aim at protecting both investors and third parties' interests by enhancing the quality and the amounts of information to be disclosed. For instance, it has been demonstrated that the correlation between executive remuneration and companies' performance has improved since the Sarbanes-Oxley (SOX) Act, promulgated in 2002 (Chen, Jeter and Yang, 2015). In the United States, such regulation is aimed at protecting investors from fraudulent accounting activities, improving financial disclosures and preventing other corporate malpractices.

Concerning this research structure, a first chapter depicts the main remuneration packages elements: base salary, benefits, short-term incentive plans and long-term incentive plans. In addition, for each component, the main features are described. Then, the literature underlying the topic is deeply analysed. In detail, the two main compelling theories explained by this research are the Agency Theory and the Managerial Power Theory. Although such two theories are seen as opposites, this research will also show how many features they actually have in common.

In a second chapter, this research demonstrates through a sample of five companies how and why members of the Board a Directors differently implement remuneration packages. The companies chosen for the sample are all small listed companies obliged to disclose remuneration data in their Annual Reports. Moreover, they all operate in the Materials sector but in different countries: The United States, the United Kingdom, Italy, Brazil, and Japan. Indeed, this research aims at showing the geographical differences in executive remuneration policies among companies similar in size and running their businesses in the same field but located in countries where the economic, political and social framework differs.

Concluding, by comparing the policies implemented by the companies in the sample, this research suggests further enhancements in Corporate Governance policies, such a better implementation of LTIPs and more detailed mandatory disclosures, which should be promoted by both the companies analysed and the regulator.

Chapter I

Conceptual Framework

I.I Pay for Performance. Elements

I.I.I Remuneration Setting Process

In the last decades, the research on the executives' remuneration has been proliferating. However, a lack of consensus within different schools of thought has come to light.

Scholars supporting social-psychological theories believe that the Agency Theory and other market-based explanations are ineffective in depicting how the "human element" influences the remuneration setting process (Maloa and Frans, 2014).

On one hand, the Cognitive, Equity, Human Capital, Social Comparison, Structural, and Contingency Theory have been developed in a Social Science environment.

This research will briefly analyse all these theories in order to underline their relevance for the matter.

i. Cognitive Theory. Accordingly, the compensation setting process consists in a psychological process which involves motivation and needs. Consequently, executives are satisfied only if their efforts match the pay they receive. In this perspective, Robbins and Judge (2011) believe that executives' remuneration is tied to how managers perceive the work environment.
ii. Equity Theory. Remuneration is the result of a comparison between the performance achieved and the award received. Gerakos, Ittner and Moers (2014) argue that managers look for "equity" when comparing their performance and pay relatively to their peers.

iii. Human Capital Theory. Sun, Zhao and Yang (2010) believe that skills and knowledge acquired through experience and education are key elements in compensation setting. Indeed, the more skilled executives perceive to be, the more their remuneration is high. Accordingly, individual's characteristics play a significant part in designing pay packages. Furthermore, the labour market "rewards" skilled employees through the access to better job positions and higher payments. Hence, since experience and education help afford a satisfactory job which, in turn, motivate employees, education and experience are a precious asset for both the employees and the organization (Greve, Benassi and Dag Sti, 2010). At last, an executive's loyalty to the company's culture is enhanced when a satisfactory job position is affordable in the labour market (Ng and Feldman, 2010).
iv. Social Comparison Theory. Corporations try to be in line with the regulatory context when setting remuneration packages, is what the Social Comparison Theory states.
v. Structural Theory. It focuses on the organization's internal structure. According to Gomez-Mejia (2010), the number of levels below an executive in the organizational hierarchy contributes to the remuneration setting process. In other words, remuneration packages depend on the job position an executive holds into the corporation.
vi. Contingency Theory. It focuses on external elements such as the environment where a company runs its business, the firm's strategy, the industry's features or the political climate. In other words, when setting remuneration packages, firms look at peer companies' practices.

On the other hand, the Agency Theory and the Managerial Power Theory have been successfully acknowledged within the Finance and Economics framework.

This research will deeply analyse both the Agency and the Managerial Power Theory. Here, this research merely refers to the aforementioned theories.

i. The Agency Theory. Since in listed companies there is a separation between ownership and control, the Agent and the Principal may have divergent interests and may perceive the risk differently. In this context, well-designed remuneration packages mitigate these agency problems aligning the Agent and the Principal's interests.

ii. The Managerial Power Theory. Accordingly, the more power executives have against the Board of Directors, the higher their compensation is, and the weaker is the relationship between executives' pay and firms' performance. In this context, well-designed remuneration packages do not mitigate agency problems (Berle and Means, 1932). Wang, Cong and Evans (2011) assert that «Firms with stronger managerial power will be more likely to pay executives excessive compensation». In contrast, when Board of Directors is more powerful, the Management earn less and the relationship between executives' pay and firms' performance is enhanced (Maloa and Frans, 2014).

So far, this research has shown how broad is the executive remuneration analysis framework.

As a matter of fact, since individuals are not completely rational, and the labour market is not perfectly efficient, classic economic theories – the Agency Theory and the Managerial Power Theory – are not enough, alone, in designing the executive compensation analysis framework. Indeed, each school of thought, from the Cognitive to the Managerial Power Theory, contributes, in a complementary way, to explain how executives' remuneration packages are set. On one hand, social-psychological theories explain the managerial behaviour. On the other hand, classic economic theories provide for an extensive analysis at the macro level (Maloa and Frans, 2014).

«Who sets CEOs pay? » (Murphy, 1999) is an additional matter for the remuneration setting process. Executives are not allowed to participate in Board of Directors' deliberations about their pay packages. However, the Management issues recommendations concerning remuneration packages to the Board of Directors, hence its influence over the remuneration setting process is significant. Furthermore, the Remuneration Committee's role is limited. The Remuneration Committee may only enforce the strategy chosen and monitor its development (Murphy, 1999).

Lastly, later on, this research will analyse each element of remuneration packages in details. Nevertheless, here, this research presents the topic in order to explain how remuneration packages are set.

Usually, executives negotiate agreements with a length of five years containing four elements: base salary, benefits – non-monetary perquisites, pension and severance, short-term incentive plans – annual bonuses settled mainly in cash, long-term incentive plans – equity-based agreements which incentivize the Management. On one hand, the composition of remuneration packages varies based on companies' objectives. For instance, when a company aims at retaining executives in a long-run vision, pension schemes are more relevant in compensation packages. On the other hand, the composition of compensation packages varies based on the "type" of executive a company wants to attract. For instance, a compensation package with a considerable annual bonus attracts risk-prone and optimistic managers (Jensen, Murphy and Wruck, 2004).

In general, companies should aim at attracting and retaining skilled executives minimizing costs and maximizing shareholders' value. Indeed, well-designed remuneration packages should encourage managers to believe they create firm's value. When implementing compensation packages, companies should create assets of lasting value allowing room for human capital growth (Jensen, Murphy and Wruck, 2004).

Jensen, Murphy and Wruck (2004) suggest that a remuneration policy which fits every company does not exist. However, the best Corporate Governance practice is the cooperation between Board of Directors, Remuneration Committees and the Management in developing a "Remuneration Philosophy" in line with the corporate objectives.

I.I.II Base Salary

Many different definitions of compensation have been given by scholars over the years. As believed by Greckhamer (2011), compensation consists in all forms of financial returns and tangible services and perks which executives receive for having an employment agreement with a company. Scholtz and Smit (2012) define CEOs remuneration as the total cash remuneration they get, as disclosed in companies' Annual Reports (Maloa and Frans, 2014).

A relevant component in remuneration packages is cash remuneration. Everyone agrees on considering cash remuneration as the sum of base salary, benefits, and annual bonuses. Nonetheless, an additional distinction, relevant for the purpose of this research, is the one between fixed and variable remuneration. Fixed remuneration includes the base salary, benefits, pension and compensation such as amounts earned as token attendance in the Board of Directors.

Since each component of the variable remuneration is computed on the basis of the amount of fixed remuneration earned by executives, fixed remuneration's characterisation is particularly significant for corporations (Maloa and Frans, 2014). As a matter of fact, pension agreements and severance, thresholds, target and caps on annual bonuses are expressed in terms of fixed remuneration (Murphy, 1999). Indeed, proxy advisory firms, such as Institutional Shareholders Services, aim at distinguishing corporations' fixed and variable remuneration and evaluating the fairness of pay packages.

As indicated in the aforementioned paragraph, the base salary is one of the elements within remuneration packages. The base salary is a periodically paid amount given to executives by companies in order to recruit, reward and retain them.

On one hand, when setting the amount of base salary, companies should consider managers' competence, area of responsibility and performance. On the other hand, base salary and other elements of remuneration packages should be set looking at Corporate Governance practices of peer companies. Maloa and Frans (2014) identify peer companies' remuneration policies as benchmarks for other companies. Market peers are usually selected according to the "size" criterion. A company's size is measured either through revenues or market capitalization. Although companies size is far from being a perfect proxy, since it ignores relevant aspects such as the aforementioned managers' experience and education, companies size is still useful to pool comparable companies which should follow similar compensation policies. Furthermore, by looking at the best practices of peer companies selected using the "dimension similarity" criterion, the link between managers' pay-off and the company which they run is enhanced (Murphy, 1999).

To finish up, even the base salary is settled in cash it may represent an incentive for executives. According to Murphy (1999), there is a relationship between executives' cash compensation and firm's performance and it can be estimated as the product between industry-level base salary's elasticity and a specific executive's base salary. Lastly, the result is divided by the market value of the company's common stock.

I.I.III Benefits

Companies aim at attracting individuals of the right calibre and ensuring that they are paid at least as much as their peers are.

"Benefits" is a broad category within remuneration packages and includes many different elements such as pension agreements, allowances specific to industries and perquisites.

During 2015, *Glassdoor* – an online platform where employees anonymously review companies – has been conducting a survey which shows that benefits and perks are a major factor in considering whether to accept a job offer (Jones, 2017). Although dissimilarities in benefits preferences, mainly due to differences in age, exist among executives, one of the perks they value most is health insurance (Jones, 2017). Health care benefits are really valuable in countries, such as the United States, where the healthcare system is private (Dulebohn, Molloy, Pichler and Murray, 2009).

Particularly, perquisites - or perks - are goods and services provided by a company to the Management. They include corporate cars and jets, cell phones, life insurance and personal security, even entertainment, such as club memberships. Furthermore, since perks' disclosure was largely hidden by corporations, they were considered a form of stealth compensation.

Concerning pensions arrangements, cash in lieu of pension, company contributions to defining contribution plans and benefits of being a member of a defined benefit scheme, all are pension costs incurred by a company.

The relevance of non-cash benefits has been rising over the years. In an Agency Theory perspective, Jensen and Meckling (1976) identify executives' benefits as an agency cost. Hence, only the Management benefits from perks consumption which is an expenditure for the company and its shareholders. Conversely, Fama (1980) believes that benefits presence within remuneration packages may enhance firm's performance sensitivity to executives' pay. Moreover, Jensen and Murphy (1990) argue that not only material benefits help align Management and shareholders' interests. Indeed, reputational benefits such as power, prestige and, honour exist and motivate managers.

In conclusion, on one hand, recent studies agree on considering the inclusion of executives' benefits into remuneration agreements as a Corporate Governance best practice. On the other hand, perquisites and other benefits need strict disclosure requirements in order to enhance executives' remuneration fairness.

I.I.IV Short-Term Incentive Plans

Short-term incentive plans are annual bonuses subject to performance conditions. When companies design short-term incentive plans, paid in different tranches, they often defer a percentage of the bonus over twelve months in order to enhance the incentivizing effect of the award and pay the upfront percentage in cash and the deferred one in company's shares for the same reason. Conversely, a less effective Corporate Governance practice is paying the award in "cliff", the full amount in one instalment.

As recommended by proxy advisory firms, when implementing short-term incentive plans, corporations should include claw-back and *malus* provisions. Through such provisions companies reserve the right to ask back already paid awards when a beneficiary's behaviour is negligent. Claw-back and *malus* provisions enable companies not to reward executives who try to game the system (Jensen, Murphy and Wruck, 2004).

From a pay-performance perspective, financial advisors suggest corporations disclose both the amount of the bonus effectively earned by executives and relative to the previous fiscal year performance, and the amount deferred which still has to be paid.

Getting to the heart of the matter, there are three core features related to short-term incentives plans: performance measures, performance standards and pay-performance relation (Murphy, 1999).

Concerning performance measures, companies often include no more than two performance measures when designing short-term incentive plans. Usually, such performance measures are earnings or profit related. Examples are Earnings Before Interests and Taxation (EBIT), Economic Value Added (EVA) and Earnings Per Share (EPS). There are both upsides and downsides of using earnings or profit related performance measures. On one hand, earnings or profit related performance measures are very easy to verify. On the other hand, they refer to previous fiscal year's results and hence they are not forward-looking. Moreover, they can be easily manipulated by executives (Murphy, 1999).

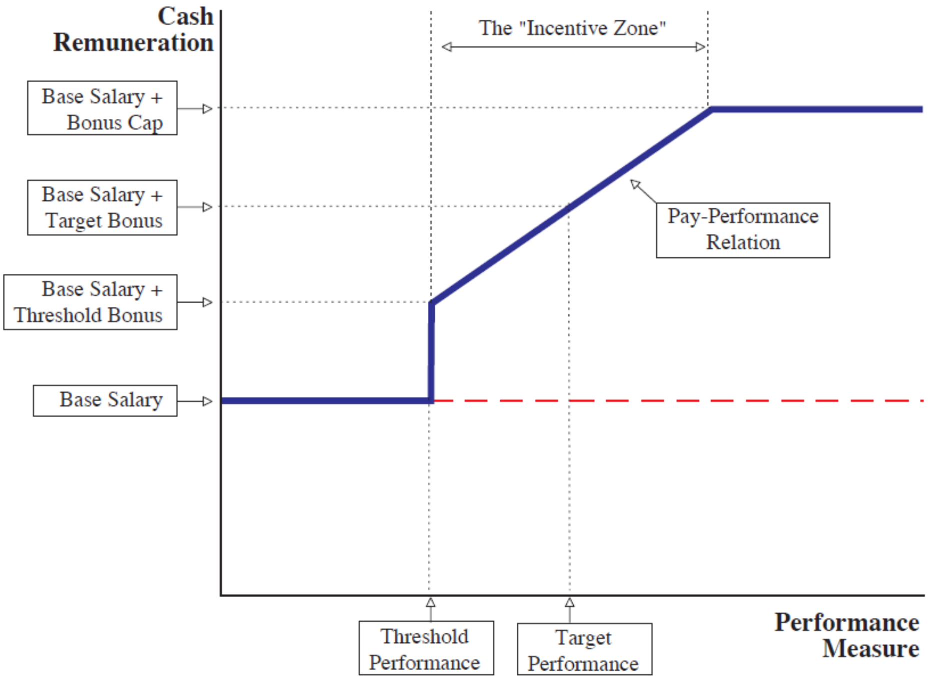
Nowadays, non-financial criteria are emerging as significant performance measures. The most widespread non-financial criteria are the "Individual" performance measures such as customer satisfaction, plant safety and increase in sales, connected to the corporate strategies undertaken by executives.

About performance criteria, different ways to design short-term incentive plans exist. "Budget" standards are related to the company's business plan; "Prior-Year" standards are based on year-to-year companies' growth; "Peer Group" standards are measured on the basis of companies operating in the same sector, with a similar performance. "Timeless" standards are, eventually, fixed standards related to the Return on Assets (ROA) or to the Cost of Capital. Each method has its pros and cons. For instance, the "Budget" and the "Prior-Year" standards leave discretion to the Board of Directors and lead to optimal, but possibly unwanted for the next fiscal year, decisions. According to proxy advisory firms, "Peer Group" standards are the most reliable ones since they cannot be easily manipulated by the beneficiaries of a short-term incentive plan (Murphy, 1999).

Concerning pay-performance structures, the most common type of plan is the so-called "Modified-Sum-of-Targets". Under this approach, each beneficiary receives an award and the sum of all the awards received by the beneficiaries of the STIP, constitutes the pool for the bonus. At fiscal year ending, the bonus pool is modified accordingly to the real performance achieved. An additional approach to design short-term incentive plans is the "Formula-Based" one. In the latter case, the bonus pool is determined by a combination of target bonuses and individual performances (Murphy, 1999).

This research has already mentioned the relevance of performance measures. Indeed, short-term incentive plans are paid on the basis of the performance achieved. Not paying any percentage of the award unless a threshold performance level is achieved, is a best Corporate Governance practice. While a certain amount of the bonus is paid if a target performance is reached, a maximum amount is given to the beneficiaries only if the performance is above cap levels previously set (Jensen, Murphy and Wruck, 2004).

Proxy advisory firms name the range between the threshold and the cap “incentive zone”. It indicates how an increment in the performance achieved, causes an increment in the award paid. Usually, the range between the threshold and the cap varies between eighty percent and hundred and twenty percent.



Base Salary and Bonus for a Typical Annual Bonus Plan – Jensen, Murphy and Wruck, “Remuneration: Where we’ve been, how we got to here, what are the problems, and how to fix them” (2004). Page 70.

The figure shows how the penalty for missing the threshold is the same of performing above the maximum level. Since managers may stop performing well when they understand they are close to the cap level, setting a performance range may become an issue (Murphy, 1999).

Nevertheless, setting performance measures and specifying accurate thresholds, targets and caps help avoid any discretion when designing short-term incentive plans.

To conclude, although some theorists have argued that annual bonuses do not encourage executives to act in shareholders’ interests since Board of Directors do not implement short-term incentive plans year after year showing a lack of interest, the effectiveness of short-term incentive is clear. Indeed, the immediacy and the tangibility of cash awards paid within twelve months provides a very strong incentive for executives.

I.I.V Long-Term Incentive Plans

Recently, long-term incentive plans have evolved into a truly significant component in remuneration packages. While in the past corporations were more willing to deliver cash to their executives, nowadays remuneration schemes include many different long-term incentive plans and in certain countries, such as the United States, options granting have almost entirely replaced monetary components (Hall and Liebman, 1998).

Since a huge increase in remuneration packages have been observed, long-term incentive plans are in the glare of the media spotlight, portrayed as tools which only enrich the Management without providing any benefit for corporations. Although, according to the public opinion, executives are excessively paid and no improvement in efficiency exists for corporations since the ‘90s there has been an explosion in political, economic and behavioral trends encouraging the long-term incentive plans adoption.

Moreover, Murphy (1999) suggests that the attractiveness of equity-based long-term incentive plans is due to the favourable tax and accounting treatment. Therefore, as soon as a company’s share price starts rising, Board of Directors implement LTIPs.

Corporations may have distinctive objectives when implementing an LTIP.

In a Human Resource perspective, long-term incentive plans are implemented in order to compete with other corporations for scarce managerial talents (Lawler, 1990; Foulkes, 1991). In Annual Reports and plan proposals, the Board of Directors asserts: “*The Board believes that the adoption of the Plan will enhance the Company’s ability to attract and retain individuals of exceptional managerial talent upon whom, in large measure, the sustained progress, growth and profitability of the Company depends…*”. This is an example from AT&T Corporation. Here, the role of cooperation within the organizational structure is enhanced and executives become critical resources to be valued, retained and rewarded (Pfeffer, 1994). Furthermore, it has been observed that when there are demographic similarities between managers and members of the Board of Directors– for instance, age or sex, or the Management is particularly authoritative, the

Board of Directors is more willing to trust the Management, and hence reward it through LTIPs (Zajac and Westpal, 1995).

In an Agency Theory perspective, long-term incentive plans, by aligning the Management and shareholders' interests, mitigate managers' shrinking behaviour (Jensen and Meckling, 1976). Furthermore, long-term incentive plans help improve firm's performance and hence, maximize shareholders' value (Kerr and Kren, 1992). In Annual Reports and plan proposals, the Board of Directors asserts: "*The new approach to compensation was recommended by the Board's Compensation Committee, which is composed solely of outside Directors. The Board believes that granting stock options, performance shares and bonuses will create a more appropriate relationship between compensation and the financial performance of the Company, in order to increase key employee's personal financial identification with interests of the Company's stockholders…*". Here, long-term incentive plans facilitate the Board of Director in monitoring the self-interested Management. Furthermore, it has been observed that when the firm's performance is poor, the Board is conscious of the existence of a misalignment between the Management and shareholders' interests. In the latter case, equity-based long-term incentive plans are an instrument to mitigate these agency problems: through stock ownership, executives and shareholders share the economic loss, and therefore executives are encouraged to work harder (Zajac and Westpal, 1995).

In the aforementioned paragraph, this research has explained how different approaches may be beyond the long-term incentive plans implementation. An additional point to develop is the description of the different kinds of long-term incentive plans. The main distinction is between equity-based LTIPs and cash-settled LTIPs. In this context, the difference between beneficiaries' awards and Total Shareholder Return should be emphasised. Indeed, while the Total Shareholder Return includes dividend payments, financial instruments in long-term incentive plans do not pay dividends.

Firstly, the most widespread form of long-term incentive plans is the option-based.

Call options are contracts which give the beneficiary the right to buy one or more shares at a pre-specified exercise price – sometimes, strike price (Murphy, 1999). Options in LTIPs usually vest in tranches during the following years after the granting, however, sometimes companies forfeit options if the share price has decreased a lot (Matsunga and Shevlin, 1998).

Concerning the vesting period, Kole (1997) have shown how Board of Directors often provides for both a minimum and a maximum vesting period, implying that a percentage of the award is available for the beneficiary of the plan after a short period of time, but the full amount becomes exercisable later. Proxy advisory firms recommend as a Corporate Governance best practice a minimum vesting period of at least thirty-six months.

Additional features are holding, *malus* and non-trade provisions. Options are canceled – do not vest, if the plan's beneficiary employee's agreement is terminated. A company reserves the right to ask back the award in case of beneficiary's misconduct, and options are not tradable. This research will later explain how such specific features lead executives to evaluate a company's options less than an outside investor would do.

Nevertheless, the main characteristic of stock options plans is the link between the managerial reward and a company' share price appreciation. Indeed, an executive's pay-out increases when the company's share price appreciates, and an executive pay-out decreases when the company's share price falls below the pre-set strike price. The variation in the beneficiary's payment is due to the method through which the payment is computed. In simple terms, the number of options granted is multiplied by the difference between the company's closing share price at the date the rights start being exercisable, and the strike price (Murphy, 1999). The usage of the Black-Scholes formula (1973) implies that changes in the fair value of the award, once the options become exercisable, are due to the beneficiary investment decisions rather than companies' compensation strategies.

Here, this research aims at clarifying the Black-Scholes formula's features.

$$\text{Option Value} = Pe^{-\ln(1+d)T}N(z) - Xe^{-\ln(1+r)T}N(z - \sigma\sqrt{T}),$$

where:

P	=	Grant-date stock price
X	=	Exercise price
T	=	Expiration term (years)
d	=	Annualized dividend yield
σ	=	Annual stock-price volatility
r	=	Risk-free interest rate
z	=	$\dfrac{\ln(P/X) + (\ln(1+r) - \ln(1+d) + \sigma^2/2)T}{\sigma\sqrt{T}}$
N()	=	Cumulative normal distribution function.

Appendix – Option Valuation and the Black – Scholes Formula. Kevin J. Murphy "Executive Compensation" (June 1999).

Under the risk-neutrality assumption – an investor is indifferent to risk when making an investment decision, the Black-Scholes is the most widespread approach to calculate an option-based award's expected value. In the United States, the risk-free rate is the annualized US Treasury yield and as a practical matter, for both *d* and σ, historical data are often used (Murphy, 1999).

Secondly, other long-term incentive plans are based on financial instruments such as restricted stock and performance shares. The overtone between the two financial instruments is subtle.

Performance shares are given to the plan's beneficiary only if performance criteria are met. Shares are "restricted" when issued under the certain conditions, first and foremost, the plan's beneficiary having an employment agreement with the company.

Here, the award value is given by the product between the number of shares issued and the company's closing share price at the vesting date.

Eventually, long-term incentive plans may be cash settled. Corporations may issue "stock-appreciation rights" which provide the plan's beneficiary for a payment corresponding to the difference between the company's market price and the pre-settled strike price, reproducing the path of an option-based plan. Corporations may also issue "phantom shares" which give the plan's beneficiary a pay-off equal to the company's share value at a future date, replicating the pattern of a restricted stock-based plan (Jensen, Murphy and Wruck, 2004). For concluding, nor "share appreciation rights", neither "phantom share" cause dilution to the company share capital, where the dilution is the reduction in the ownership percentage due to the issuance on new company's shares.

One last issue this research should mention in the paragraph is the relationship between long-term incentive plans and firm's performance.

On one hand, some theorists – Bebchuk and Fried (2003), have argued that equity-based LTIPs often reward executives for luck, for share price increases due to market conditions which are beyond executives' influence.

On the other hand, Murphy (1999) have shown how a relationship between pay and performance exists. The pay-performance sensitivity for option-based plans can be computed as:

$$\text{(Options Granted) / (Shares Outstanding))} * \partial\text{(Option Value)}/\ \partial\text{P}$$

It is possible to compute pay-performance sensitivity also for other long-term incentive plans by dividing the total award given to all the beneficiaries each fiscal year by the change in shareholders' wealth occurring during the total period of time covered by the plan.

A final remark concerning pay-performance sensitivity is about the difference between an executive being beneficiary of a long-term incentive plan and an outside investor. Plan's beneficiaries value company's options less they an outside investor does. Indeed, executives are forbidden to trade the options received. Furthermore, since executives are prevented from hedging the risk by short-selling, they are risk-averse. Equity-based incentive plans should be implemented only when the "incentive effect" (Murphy, 1999) – that is, an increase in managers' performance – is higher than the difference between the company's cost of implementing the plan and the value executives attribute to the company's financial instruments (Murphy, 1999). Long-term incentive plans should be well-designed in order not to be an excessive cost for corporations and not to destroy company's value. Indeed, as mentioned before, long-term incentive plans should be implemented only when the "incentive effect" creates enough value to cover the costs.

In conclusion, LTIPs require an increased monitoring from the Board of Directors. Financial Statements manipulation should be duly punished. Audit Committees should prevent executives to pump up the company's share price, and hence increase their pay-off, by manipulating financial statements. However, within all the different elements in remuneration packages, long-term incentive plans' implementation is a Corporate Governance best practice which enables companies to mitigate agency problems by aligning the Management and shareholders' interests.

I.I.VI Others

"Other Compensation" includes payments which do not fit into any other category such as Board and other Committees attendance fees, severance, one-off or guaranteed bonuses, and proceeds from executives' loans.

Elements such as severance and one-off or guaranteed bonuses may arouse some concern. As a matter of fact, proxy advisory firms recommend corporations limit the usage of termination agreements which provide for high severance payments. The amount of severance payments is often expressed as a multiple of the base salary and it should not exceed two years of the base salary. Furthermore, according to Jensen, Murphy and Wruck (2004), when an executive is terminated for cause – grave misconduct – severance payments should be avoided. Severance payments should be avoided even when executives have performed poorly (Bebchuk and Fried, 2003). Covenants are an additional typical feature of termination arrangements. They are non-competition clauses which prevent an executive from exploiting a company's confidential information or trade secrets once the employment is terminated.

Recently, corporate takeovers have been on the increase. The threat of a successful takeover which can lead to the Management replacement has urged corporations to grant *una tantum* awards which are not linked to performance. Indeed, under special circumstances, such as changes in control - Mergers and Acquisitions – "Golden Hello", "Sign-on Bonuses", "Transaction Bonuses", "Golden Parachute" are paid to executives. In this scenario, Bebchuk and Fried (2004) believe that "Change-in-Control" arrangements are an effective takeover defense tool. However, financial advisors, when assessing the fairness of executives' remuneration, devote particular attention to the amounts earned by executives which are not performance related. Indeed, payments for "Golden Hello" or "Golden Parachute" might be excessive and unwarranted.

An additional controversial practice is executives' loans granting. In fact, loans better-off the Management through favourable interest rates. Furthermore, loan forgiveness when the company stock price falls below the amount due on the loan is a poor Corporate Governance policy, often conducted by corporations.

At last, this research should mention executives stock ownership. In point of fact, stock ownership is a special element into remuneration packages intended to encourage managers to acquire company's shares. The alignment of the Management and shareholders' interests is enhanced by stock ownership although stock ownership is not a performance related element of pay packages (Jensen and Murphy, 1990). Supposing there is the possibility to invest in a risky project with a positive net present value, executives with a significant stock ownership percentage in the company, are more willing to invest and bear the risk of the investment opportunity (Murphy, 1999). On the other hand, stock ownership provides a solution even for those agency problems which are due to the Board intermediation between the Management and shareholders. Indeed, stock ownership implies the grant of voting rights. Voting rights provide members of the Board of Directors with more authority which lead them to be less influenced by the Top Management when setting remuneration packages.

I.II Literature

I.II.I The Relationship between Executive Compensation and Firm Performance

In large corporations, CEOs strategic status is broadly acknowledged, since Top Management's activities and decisions may have a large impact on companies' performance. Undoubtedly, companies aim at optimising executives' actions and decisions because firms' performance is what determines the amount of the Total Shareholders Return.

The executives' compensation analysis is a key element in the broader debate on Corporate Governance and therefore this research focuses on many different topics in the Corporate Governance field.

Recently, many changes have occurred at a global level which has led to increasing concern about Corporate Governance issues. Corporate Governance, and more specifically executives' compensation has not only aroused interest from Finance and Economics scholars but has also stimulated inquiries from a wider public. Many factors have contributed to research flourishing; the issue has acquired more and more relevance as a result of globalization competitive pressure, development of new technologies, economic and financial crisis and scandals, environment, and people protection needs.

These phenomena brought to a greater stakeholders' sensitivity towards the sustainability of companies' Governance. The integration of Corporate and Social Responsibility (CSR) practices into the executives' remuneration system may contribute, in this sense, to the meeting of investors' expectations (Maas, 2015).

A first aspect emerging from the analysis of the relationship between executive's compensation and firm performance is the separation between ownership and control. Generally, shareholders delegate to the executives the task of managing firm's operational activities, with the aim of increasing the enterprise value. This might lead to agency problems, due to the conflicts of interests arising between the Management and shareholders. These conflicts of interests can be however mitigated by the intermediation of the Board of Directors which, acting on shareholders' behalf, has the power to redirect CEOs decisions in three different ways. In the first place, the Board of Directors has the discretion to indicate an insider CEO, promoted within the organisation, or an outsider one. Secondly, it can settle the executives' compensation structure and level on. Lastly, the Board of Directors can appoint a successor to the incumbent CEO (Murphy, 1999).

However, for the purpose of this research, we will focus only on executives' compensation as an incentive tool.

Executives' remuneration is a controversial topic. While in the past many theorists believed that executives' remuneration level and structure were both determined by firm performance, most recent studies show how executives' pay has an influence on firm performance, and not vice versa.

The questions to be answered are: «Is compensation a motivational tool which can enhance a company performance? » and «Are firms, whose CEOs are more pleased by their pay, higher-performing firms? » (Murphy, 1999).

There two aspects related to the relationship between CEOs pay and companies performance. First, there is an *explicit* aspect: executives' remuneration is tied to accounting returns through both short-term incentive plans and long-term incentive plans. Secondly, there is an *implicit* aspect: executives' remuneration is implicitly linked to the company performance through year-to-year changes in salary levels, bonuses, and equity-based incentives. However, most of the pay-performance sensitivity is attributable to the *explicit* aspect (Murphy, 1999).

The literature about executives' compensation has deeply discussed how remuneration contracts can be a solution to agency problems. Indeed, if well-designed, they may align managers' interests with shareholders' ones and maximize shareholders' value. As a result, remuneration packages which include both short-term and long-term incentive plans may enhance the relationship between executives' pay and firm performance.

In fact, the impact of manager share ownership on firm value has been questioned for a long time and it is still objective of many compensation scholars research. Since the 1980s, scholars have been investigating the link between Management decisions and compensation packages. Many studies have found a positive correlation between both equity and cash executives' incentives and firms' value, implying that a well-designed executives' compensation package should cause an increase in firms' performance encouraging executives to take appropriate actions and decisions (Maas, 2015).

Agency Theory seems to provide satisfying explanations. Incentive plans in executives' agreements would be useless if executives' activities were perfectly observable. Indeed, in a hypothesis of perfect information where shareholders can tell CEOs which actions to take there is no need to link pay to performance. However, the real state of the world is a scenario where the information is not perfect. In this scenario, CEOs have to be evaluated in part by directly observing their activities, and in part by observing the output of their decisions, which affects shareholders wealth, here the reason why shareholders need to incentivise the Management.

On one hand, managers often have better information than shareholders in identifying superior investment opportunities and in assessing projects' profitability, and this is the reason why there is a separation between ownership and control. On the other hand, managers are not risk-neutral. Being beneficiaries of incentives plans or owning a percentage of the company's share capital, makes executives less inclined to irresponsible activities (Jensen and Murphy, 1990). Therefore, including long-term incentive plans in remuneration packages generates appropriate motivations for executives to improve firm's performance (Jensen and Murphy, 1990).

There are many pieces of evidence that executives respond to pay scheme and thus, that award systems are effective in improving firm's performance. For instance, Jensen and Kaplan have found out that an increase in firm performance is linked to top Management incentives. In the latter case, the hypothesis that companies' rise in market value and improved productivity is also due to executives MBOs and long-term incentive plans is consistent (Jensen and Murphy, 1990).

Although the effectiveness of the Agency Theory is widely recognised, some other theorists have argued that not always well-designed remuneration packages help reduce the moral hazard problem.

According to Bertrande and Mullainathan (2001), CEOs are not only rewarded for their contribution to increase firm performance, but they are also rewarded for luck. Where luck is meant to be changed in the company performance which are beyond executives' control. For instance, exchange rate movements are not under CEOs control since they are caused by macroeconomic variables.

Furthermore, pay for luck not only appears in the discretionary components of remuneration such as base salary and bonuses but also in stock options plans. Indeed, options are deemed to contain a “gift” element. In this perspective, although executives’ decisions would not affect the company’s share price, executives are rewarded for the intrinsic value of the stock issued, which is computed with the Black-Scholes Method.

Additionally, pay for luck seems higher among firms with poor Corporate Governance, while where shareholders presence is strong, pay for luck decreases.

Executives rewarded for luck has become a relevant topic to discuss in the pay-performance context. Jensen, Murphy and Wruck (2004) have made their contribution to the debate asserting that executives should be accountable also for what happens in the macroeconomic environment when they can influence the impact of such macroeconomic variables on firm performance. Indeed, it should not happen that CEOs do not take responsibility only because they are not the “intrinsic cause” of macroeconomic changes.

Moreover, small annual changes in executives’ remuneration suggest that remuneration itself may actually be unrelated to performance measures. It has been observed that, on one hand, executives are less likely to have their pay cut than other employees. On the other hand, executives are more likely to receive raises. As a result, Remuneration Committees seem to be not really focused on the development of well-designed remuneration packages and hence not confident about the effectiveness of remuneration packages as a tool to mitigate agency problems.

Conversely, since variable remuneration is a significant component of remuneration packages, it should be improved year after year. Indeed, Remuneration Committees should frequently adjust the variable component of remuneration in order to have it flexible to changes occurring in both the firm’s organizational structure and in the macroeconomic environment. Frequently adjusting remuneration packages may help link pay and performance. In the latter case, the hypothesis that CEOs are rewarded for luck becomes less acceptable (Jensen and Murphy, 1990).

Another question which needs to be answered is «Why companies use performance-related pay? » (Bender, 2004).

In the subsequent paragraphs of this first Chapter, we will analyse more deeply the core theories underlying executives’ remuneration. However, we may already mention some basic concepts.

Companies need legitimacy not only from the Government but also from other public institutions such as labour unions. Moreover, granting stock options and providing for other long-term incentive plans is a widespread market practice. Last but not least, under a Human Resource Management approach companies need to attract and retain skilled managers. Hence, firms implement reward schemes which are aimed at enhancing the firm's performance and which contain performance measures and targets in line with the firm's strategy. The purpose is incentivising executives' actions, behaviours and decisions which have an impact on the business performance. Nonetheless, not only executives' actions, behaviours and decisions affect the business performance but also external factors which are beyond CEOs influence. In the latter case, they are somehow rewarded for luck. This process leads to a continuous implementation of incentivising awards (Bender, 2004).

To conclude, from a market efficiency perspective, a company current stock price incorporates all the information available including the one on managers' pay-performance sensitivity. For instance, supposing that Firm A has better managerial incentives since such an information is publicly available, Firm A's share price is already higher than the share price of another company with weaker managerial incentives (Murphy, 1999). Hence, investors believe that Firm A is going to perform well with a hard-working and skilled Management pursuing shareholders' interests. This belief makes Firm A stock price increase further (Murphy, 1999).

There are other significant aspects which should be investigated but are only mentioned in this research.

First, since executives in big companies may only own a small percentage of the company's shares through equity-based LTIPs, pay-performance sensitivity is smaller in larger firms. In the latter case, company size plays a part in determining pay-performance sensitivity (Murphy, 1999).

Secondly, pay-performance sensitivity varies across different industries. For instance, CEOs in the financial industry earn more than CEOs in other industries (Barro and Barro, 1995; Hubbard and Palia, 1995).

Furthermore, other organizational theories suggest how significant is executives' perception of both personal and company wealth (Lawler, 1981). Indeed, «Firms whose CEOs perceive greater connection between their personal wealth and the wealth of the firm will be higher-performing firms» (Murphy, 1999).

Lastly, the postponement of managers' retirement age has also an impact on the relationship between pay and performance (Murphy, 1999).

So far, the Agency Theory seems to be the most convincing hypothesis among all the others have been formulated over the time and concerning the link between pay and performance, the so-called pay-performance sensitivity. This does not imply that the research on the matter has come to an end. Instead, the debate should go on and other questions should be addressed. For instance, «Do executives deeply understand how they affect the company' performance? » Surely, executives are a resource for organizations, but executives' compensation has still too many facets to be considered a topic sufficiently analysed.

I.II.II The Agency Theory

Jensen and Meckling argued that in listed companies there is a separation between ownership and control. An agency relationship exists when the Principal hires the Agent to act on his behalf. Since shareholders do not have as much information as the Management to monitor all the decisions taken during the course of the everyday business, executives, the Agent, run the company on shareholders' behalf, the Principal.

The usage of the delegation tool due to the separation between ownership and control, in the Agency Theory perspective, addresses some problems. Firstly, the problem arising when the Principal's wants are in conflict with the Agent's one, and the Principal is unable to verify the Agent's actions. Secondly, the Principal and the Agent may have different attitudes toward risk.

Although managers are smart and talented, shareholders should understand that managers often take decisions which are different from the ones they would have taken themselves. In addition, the Agency Problem is even more evident when executives have to take decisions which are costly for them, such as selling a division, or decisions from which they may benefit, such as renovating corporate headquarters.

The intermediation of the Board of Directors between shareholders and Management might represent an additional issue for most of the listed companies. Indeed, since shareholders do not interact directly with the Management, their interests are conveyed by a third subject against which the Management holds a strong bargaining power (Jensen, Murphy and Wruck, 2004). Additionally, shareholders value maximization may be overshadowed because of the Board of Directors members' willing to be re-elected, enhance their reputation and enjoy non-monetary benefit. Hence, for all these reasons, directors need executives' support (Bebchuk and Fried, 2003).

Jansen and Murphy (1990) depict remuneration policy as instrumental in matching the Agent's and Principal's objectives within the context of listed companies. Linking the level of executives' remuneration to the path of shareholders' value, paves the way to an alignment of the Management and shareholders' interests that turns to a mitigation of the agency problems.

What emerges from the research conducted by Prendergast (1999), is a consistent connection between the implementation of short and long-term incentive plans, within compensation packages, and enhanced firm's performances. These performance-related awards result even more effective in aligning Management and shareholders' interests when they are equity-based (Bender, 2004).

From an overview of the theoretical background, the most agreed approach to the debate over executive compensation resulted to be the so-called "Optimal Contracting Approach". This approach, which can be categorized as one of the aspects of the Agency Theory, looks at the "Contract" in general and, in turn, at the Executive's Remuneration as remedies to the Agency Problem (Bebchuk and Fried, 2003). In this perspective, also high executive's payments are tolerated, to the extent that they are aimed at increasing shareholders' value.

The "Optimal Contracting Approach" predicts the usefulness of well-designed incentive plans in aligning the interests of risk-averse and selfish executives with the ones of shareholders, enhancing the pay-performance sensitivity. Hence, in a so-called "hidden action" scenario, where information asymmetries exist, an executive is assumed to take actions, a, to produce shareholders value, $x(a)$, receiving compensation $w(x,z)$ and utility $u(w,a)$, where z is the vector of observable measures other than shareholders' value in the contract.

The executive's utility function, and the production function linking the executive's actions to the output are common knowledge to both shareholders and the executive. However, because of information asymmetries, while the executive can observe the actions he takes, shareholders only know what actions they want the executive to take but they do not know the actions effectively taken by the executive.

In the latter case, the optimal contract, *w(x,z)*, maximizes the risk-neutral shareholders' objective, x-w, subject to an incentive compatibility constraint (the executive chooses actions to maximize *u(w,a)*) and a participation constraint (the expected utility of the contract must exceed the executive's reservation utility).

The traditional Principal-Agent model highlights the trade-off between risk and incentives. Suppose that the firm value is given by $x = e + \varepsilon$, where e is the executive's effort, and ε is the, normally distributed, uncontrollable noise, $\varepsilon \approx N(0, \sigma^2)$.

Furthermore, suppose that managerial contracts take the simple linear form $w(x) = s + bx$, where s is a fixed salary and b is the pay-performance sensitivity. Assuming that the executive has exponential utility:

$$U(x) = -e^{r(W-c(e))}$$

Where r is the executive's absolute risk aversion and $c(e)$ is the convex disutility of effort, the optimal pay-performance sensitivity is given by:

$$b = 1 / (1 + r\sigma^2 c'')$$

This equation implies that the optimal pay-performance sensitivity will equal b=1 when output is certain ($\sigma 2 = 0$) or executives are risk-neutral ($r = 0$). Incentives will be weaker for more risk-averse executives ($\partial b/\partial r < 0$), and will also be weaker the greater the uncontrollable noise in firm value ($\partial b/\partial \sigma^2 < 0$) (Murphy,1999).

The reason why shareholders believe that self-interest executives are still indispensable for the company is that they are more skilled and more informed. As a matter of fact, investing in positive net present value projects, defining business strategies, selecting industries and markets to enter or exit, setting budgets, choosing between debt and equity financing are decisions which, for sure, executives take better than shareholders (Murphy, 1999). Here, trust becomes essential.

In conclusion, remuneration packages under the Agency Theory perspective may help mitigate agency problems. Nonetheless, implementing Corporate Governance best practices is helpful to guarantee that shareholders guidelines are matched by members of the Board of Directors. Hence, well-designing managers’ pay is just one of the many tools a company has to enhance its performance.

Furthermore, Corporate Governance and remuneration are inter-related: poor Corporate Governance practices may cause value-destroying pay policies, and excessiveness in pay packages may lead to failures in Corporate Governance (Jensen, Murphy and Wruck, 2004).

Nonetheless, implementing Corporate Governance best practices is helpful to guarantee that shareholders guidelines are matched by members of the Board of Directors. Hence, well-designing managers’ pay is just one of the many tools a company has to enhance its performance.

I.II.III The Managerial Power Theory

The Managerial Power Theory, developed by Bebchuk and Fried during the first years of the XXI Century, is a viable alternative to the Agency Theory in founding out whether or not there is a link between executives’ remuneration and firm’s performance.

So far, the purpose of this research has been demonstrating how executives’ remuneration, in an Agency Theory perspective, may mitigate agency problems due to the separation between ownership and control in listed companies. Therefore, this paragraph is aimed at illustrating the Managerial Power Theory which truly is a challenge (Van Essen, Otten and Carberry, 2012) for the Agency Theory.

This research has already mentioned how the intermediation of the Board of Directors between the Management and shareholders might represent and additional issue. In fact, Bebchuk and Fried (2003) believe that when executives have a great influence over Board members, they are able to set higher compensation packages for themselves. As a result, Management and shareholders’ interests are not aligned and pay-performance sensitivity is way lower.

In the Managerial Power perspective, two questions should be answered (Van Essen, Otten and Carberry, 2012): «Do powerful CEOs have higher compensation levels than weaker CEOs? » and «Do powerful CEOs have a less sensitive compensation to firm performance than weaker CEOs? »

Van Essen, Otten and Carberry (2012) find out different Corporate Governance features which may define the intensity of CEOs power against the Board of Directors:

i. CEO Duality. CEO Duality occurs when a CEO holds the position of both Chief Executive Officer and Chairman of the Board of Directors. In the latter case, since the CEO's power against members of the Boars is greater, the level of CEO remuneration is higher and pay-performance sensitivity weaker.
ii. CEO Tenure. The longer executives are in charge, the better they understand company's dynamics. With better information, executives' influence over the Board grows leading to higher compensation level and a weaker pay-performance sensitivity.
iii. Size of the Board. The larger is the Board size, the more the possibility that a lack of coordination and communication occurs within a company, increases. When there is a lack of coordination and communication the Board of Directors becomes unable to constrain executives' managerial power. Therefore, CEOs set higher pay-offs for themselves weakening the relationship between compensation and firm's performance.
iv. Percentage of Independent Directors. The higher the percentage of independent directors in the Board, the more its members succeed in constraining managers' power. As a result, CEOs pay decreases and pay-performance sensitivity is enhanced.

Summing up, when executives power against the Board of Directors is stronger, they have more chances to influence the level and the structure of their remuneration packages. In this perspective, compensation policies are not an effective instrument to mitigate agency problems, but the root of such issues themselves. Consequently, a relationship between executives' compensation and firm's performance does not exist or whether exists, it is weak (Bebchuk and Fried, 2003).

Furthermore, the Managerial Power Theory clarifies what "managerial power" means. According to Chen (2011), two types of executives' power may exist. On one hand, the Management has "structural power". "Structural power" increases as executives climb the corporate ladder and every increase in the "structural power" make an executive more powerful against the Board of Directors. On the other hand, the Management has "prestige power" against the outside environment (Maloa and Frans, 2014).

Maloa and Frans (2014) believe that executives' power is the result of their experience, education, and skills. The more experience a CEO has, the more a CEO is educated and skilled, the more bargaining power the CEO has in negotiating the level and structure of remuneration packages.

Van Essen, Otten and Carberry (2012) have conducted a deep research in order to find evidences which may demonstrate the effectiveness of the Managerial Power Theory. However, the data collected among a sample based on companies listed on S&P 500 Index, S&P 1500 Index, *Forbes*, *Fortune* and *Business Week* show that the Managerial Power Theory is effective in explaining how remuneration packages' level and structure are set, but it does not succeed in describing the relationship between executives' compensation and firm's performance. As a result, the Managerial Power Theory may clarify why executives prefer less risky form of remuneration such as cash bonuses in their pay packages, but it does not suggest how cash bonuses may represent an incentive for executives.

Furthermore, remuneration packages excessiveness may be reduced when enhancing the Board of Directors authority. Media press and shareholders resolutions in Annual General Meetings may be beneficial for the cause as well.

To conclude, although the Managerial Power Theory suggests that the Optimal Contracting Approach is not sufficient alone in designing a qualified framework for the executives' remuneration analysis (Bebchuk and Fried, 2003) the Managerial Power Theory and the Optimal Contracting Approach should not be seen as competing ideologies (Van Essen, Otten and Carberry, 2012). The Managerial Power Theory is surely antithetical to the Agency Theory, when asserting that there is no link between pay and performance since managers have power against the Board of Directors to set their remuneration packages themselves. Nonetheless, both the Agency Theory and the Managerial Power Theory show how problems arise from a divergence in interest. As a matter of fact, the Managerial Power Theory represents just one of the numerous Agency Theory nuances. The Board of Directors intermediation between the Management and shareholders is an additional agency issue which may be mitigated through the usage of well-designed remuneration packages and other Corporate Governance best practices.

Indeed, well-designed remuneration packages may align interests of managers, members of the Board and shareholders.

Chapter II
Empirical Analysis

II.I Some Insights

II.I.I Key Performance Indicators (KPIs)

A performing company is a company which achieves its objectives using its assets to generate revenues.

In general, there are three parameters which indicate whether or not a firm is performing well: effectiveness, efficiency, and economy. Effectiveness, that is the ability to achieve objectives; efficiency, the output maximization; economy, so costs minimization.

In this framework, performance measures are the qualitative and quantitative criteria which evaluate a process, an employee or an asset's performance.

In 2006, the British Parliament issued the Company Act, a law for corporations and businesses. Accordingly: « *"Key Performance Indicators" means factors by reference to which the development, performance or position of the business of the company can be measured effectively.* ». Indeed, Key Performance Indicators help measure a corporation's performance relative to the objectives it has previously set.

One of the Big-Four Consulting Firms, Price-Waterhouse-Coopers, recommends its customers implement an effective communication with the company's shareholders through Key Performance Indicators tied to the company's strategy (PwC "Guide to key performance indicators", 2007). In fact, KPIs should be defined on the basis of the enterprise strategy (Matè, Trujillo and Mylopoulos, 2017).

Measuring a company's success implies considering many different metrics. More specifically, the Management should explain why a certain performance criterion is relevant in evaluating the firm's performance and disclose in detail how the criterion has been computed. Indeed, shareholders should understand the KPIs the Management has chosen and the reason behind such choices. The assumptions made for KPIs computation should be disclosed as well.

Additionally, old metrics should be frequently updated. KPIs should evolve over time with the company's strategy and with changes in the information available. Therefore, the Management should explain why any change has occurred.

Although specifying how many Key Performance Indicators a company should implement is not possible, Badawy, El-Aziz, Idress, Hefny and Hossam (2016) believe that the fewer KPIs a company includes in its performance analysis, the better such KPIs work. Indeed, including too many KPIs may weaken the focus on strategic objectives.

Lastly, concerning the KPIs' specification, most of the time the Management prefers reporting the KPIs separately for each business segment. However, an optimal solution which fits every company does not exist. The Management should always be creative and flexible when implementing performance criteria for the enterprise.

Traditionally, corporations, in order to verify the achievement of organizational objectives, have been focusing on financial performance criteria, such as the Return on Investment (ROI) and the Return on Equity (ROE).

The identification of financial ratios which can predict a company's performance has been objective of many type of research. Accounting and financial theorists differentiate ratios into different categories such as liquidity, solvency and profitability ratios. Liquidity ratios evaluate the company's ability to pay short-term liabilities while solvency ratios measure the company's ability to pay long-term liabilities. Profitability ratios examine the company's profit-generating ability through sales, equity, and assets. For instance, a profitability common measure is the Return on Assets (ROA), the ratio between the sum of Net Income and the Interest Expense After Tax, and the Average Total Assets. The issue with the ROA is that its calculation mixes up financing and operating activities both in the ratio's numerator and denominator (Bozzolan, Raoli and Magnanelli, 2016).

ROA = (Net Income + Interest Expense After Tax) / Average Total Assets

The Return on Common Equity (ROCE) is an additional ratio often included in performance metrics by corporations. The ROCE is the ratio between the Comprehensive Income and the Average Common Shareholders Equity.

ROCE = Comprehensive Income / Average Common Shareholders Equity

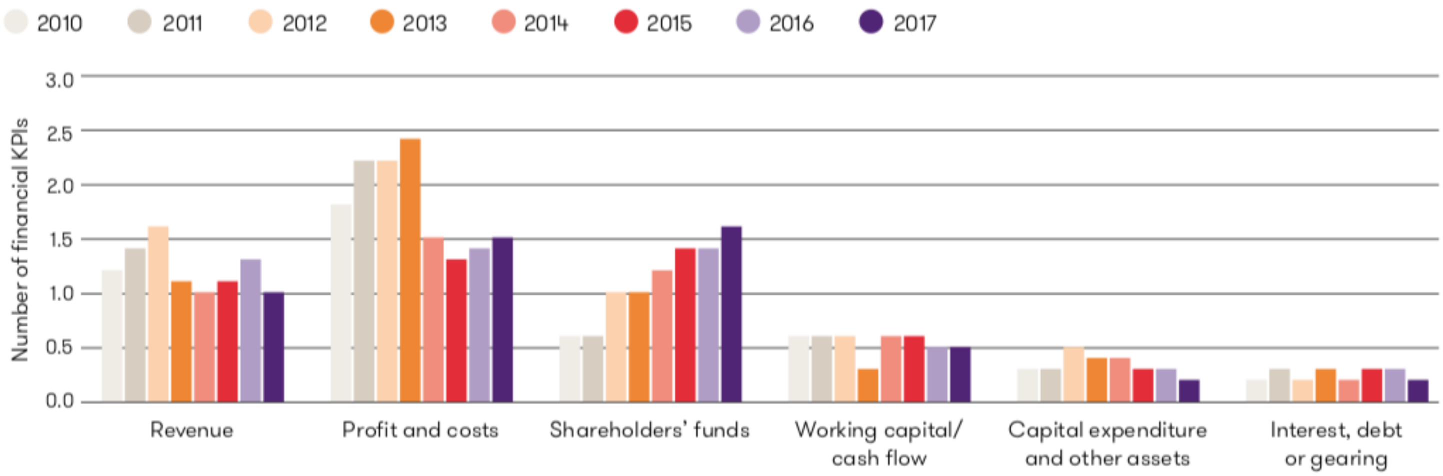
Furthermore, the ROCE can be analysed at three levels. In brief, firstly, distinguishing the impact of both operating and financial activities on the firm's performance. Then, analysing the effects of profit margins – the profitability of each dollar of sales, and asset turnovers – the measure of sales revenue per dollar of the net operating assets in place. Eventually, an additional breakdown is made possible through the computation of the profit margins, the asset turnovers and the net borrowing costs' drivers (Bozzolan, Raoli and Magnanelli, 2016).

In general, financial ratios are computed using variables reported in Financial Statements in order to measure managers or departments' performance, provide information to shareholders and predict the future company's performance (Delen, Kuzey and Uyar, 2013).

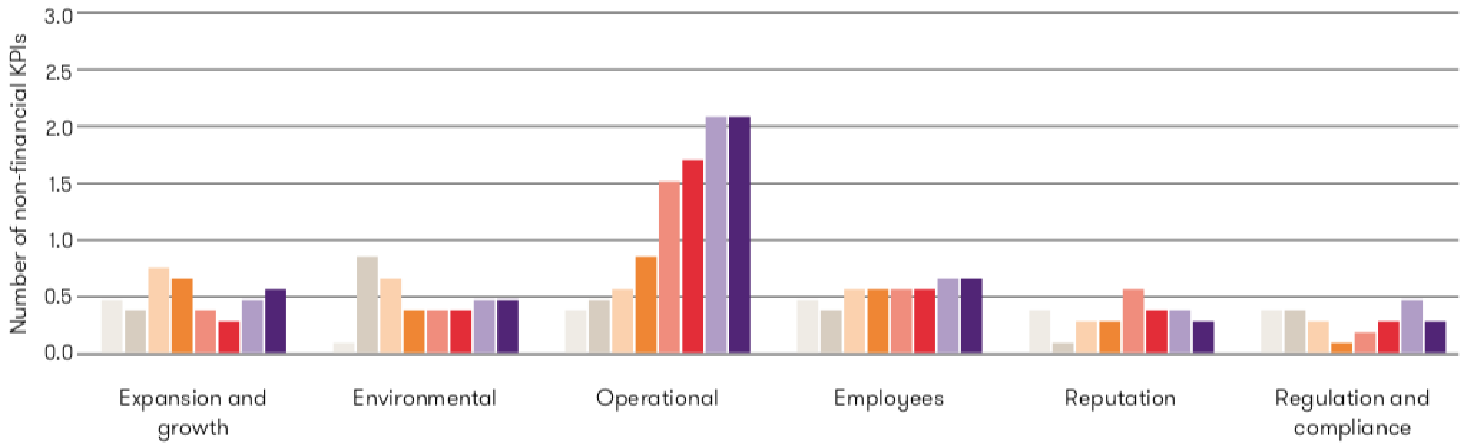
Nonetheless, many downsides follow the usage of financial ratios as performance criteria. Firstly, they mainly focus on the company's short-term horizon. Secondly, financial performance criteria lack of strategic planning, and hence financial performance criteria do not provide for significant information such as information about quality. Furthermore, from an executive compensation perspective, financial performance criteria do not properly enhance the relationship between pay and firm's performance.

Since a company should communicate its strategy, maximize its customer experience, retain its best employees, Boards of Directors and Remuneration Committees should identify different KPIs instead of focusing merely on financial criteria. In fact, the most challenging Key Performance Indicators are those which allow both the Board of Directors and outside investors to evaluate whether progress compared to old strategies have occurred.

In 2017, Grant Thornton, a leading consulting company, has analysed the latest trend concerning the usage of financial KPIs among UK companies. Below the results.



Average of financial KPIs disclosed in the United Kingdom. Grant Thornton "Corporate Governance Review" (2017).



Average of financial KPIs disclosed in the United Kingdom. Grant Thornton "Corporate Governance Review" (2017).

An additional feature is the KPIs' industry-specificity, that is the degree to which Key Performance Indicators are influenced by the industry where corporations operate. For instance, a firm operating in the Retail sector may use "sales" or "customer satisfaction" as performance criteria whereas a company operating in the Oil and Gas sector may choose "exploration success" as a KPI.

However, Key Performance Indicators should be relevant for the company itself without being too standardized accordingly to KPIs adopted by peer companies operating in the same industry. At last, although performance benchmarking against a significant external peer group is valuable since it suggests who the company's competitors are, the Management should opt for the adoption of KPIs which, firstly, are in line with the firm's strategy and objectives and it should explain the details related to the measurements methods.

Here, some KPIs as indicated and grouped, according to some different industries, by Price-Waterhouse-Coopers:

Banking	Petroleum	Retail
Customer retention	Capital expenditure	Capital expenditure
Customer penetration	Exploration success rate	Store portfolio changes
Asset quality	Refinery utilisation	Expected return on new stores
Capital adequacy	Refinery capacity	Customer satisfaction
Assets under management	Volume of proven and probable reserves	Same store / like-for-like sales
Loan loss	Reserve replacement costs	Sales per square foot / meter

Exhibit 2: Measures that matter across industries. Price-Waterhouse-Coopers - PwC - "Guide to key performance indicators" (2007).

Concluding, this research has already shown how performance criteria are essential for the enhancement of both short and long-term incentive plans. When KPIs are well-designed by the company implementing an incentive plan, they strengthen the relationship between executives' remuneration and firm's performance. Although some companies still focus on financial criteria based on quantitative information, many are moving beyond the tradition. KPIs enable companies to compare themselves to their peers, help gather the information needed to achieve corporate objectives, benefit the Management in planning and controlling the company's activities, create transparency and support the decision-making process within the organization.

KPIs may also suggest how to increase the performance. Indeed, forward-looking Key Performance Indicators show whether a company's performance has improved or worsened over time.

I.I.II The Relevance of the Size

Corporations' size is one of the factors which has an impact on executives' remuneration. The concept of firm size is complex. It may be differently interpreted, accordingly to specific theories, and it may suggest some implications. Firstly, the optimal size for a corporation depends on distinctive factors such as the production technologies which characterize the industry where the company operates. Then, the size determines the organization's complexity and influences the number of coordination costs (Beck, Demirguc-Kunt, Laeven and Levine, 2005).

Concerning the different existing interpretations of the concept of size, Market Capitalization, and Total Firm Value are the most widespread ones. Indeed, for his research about the relationship between executive compensation and firm size, Kaplan (2012) uses Market Capitalization while Gabaix, Landier and Sauvagnat (2013) prefer the Total Firm Value.

On one hand, the Market Capitalization is the total market value of a company's outstanding shares. In fact, it is obtained as the product between the number of a company' s outstanding shares and the market price per share.

On the other hand, the Total Firm Value refers to the sum of the company's debt and equity. In fact, the Total Firm Value is computed as the sum of the market value of equity – the number of shares outstanding times share price and the book value of debt – defined as total assets minus the sum of the book value of equity. Gabaix, Landier and Sauvagnat (2013) believe that since the Total Firm Value does not depend on the company's leverage choices, the Total Firm Value is more appealing than the Market Capitalization.

An additional consideration concerning the firm size may be linked to the nature of the role played by the CEO within the organization. A company's size may be measured by sales or earnings recorded during the fiscal year when the strategy implemented by the Top Management has a huge but temporary impact on productivity or revenues. Nevertheless, when the company firmly believes in the long-lasting positive contribution of CEO's activities and decisions, the best indicator for the company's size is the Total Firm Value, also measured as the net present value of the stream of future profits.

Concerning the relationship between firm size and executives' pay, according to the Allocation Control Theory (Lau and Vos, 2004), the most skilled managers work for the largest companies and hence a positive relationship between firm size and executive pay exists. In brief, CEOs' remuneration increases with companies' size. In addition, Kostiuk's research (1990) has shown how such relationship between managers' compensation and enterprises' size is moderately stable over time and in different countries.

Furthermore, in an Agency Theory perspective, Jensen and Murphy (1990) observed that if the firm size is positively related to executives' remuneration, the firm size is also negatively related to the pay-performance sensitivity. As a matter of fact, since the Management is more influential in smaller companies, the probability that executives are rewarded for their actions and decisions increases. Conversely, in big companies, executives are often overpaid for "luck", meaning that they are rewarded for improvement in the firm performance which are due to external factors.

meaning that they are rewarded for improvement in the firm performance which are due to external factors.

For the purpose of this research, the firm size is significant for the choice of the five companies analysed. Indeed, in order not to lose the geographic dimension, the pool is made of five companies listed in the Small Cap Market Indexes of each Country, that is the United States, the United Kingdom, Italy, Japan and, Brazil. Indeed, remuneration policies implemented within large multinational companies operating all over the world do not capture the relevance of geographical differences in Corporate Governance practices.

II.I.III The Relevance of the Industry

Bloomberg distinguishes between eleven different sectors: Energy, Financials, Materials, Industrials, Information Technology, Health Care, Real Estate, Consumer Discretionary, Consumer Staples, Telecommunication Services and Utilities.

This research aims at showing the geographical differences in executives' remuneration practices through a sample of five companies chosen in five different countries, similar in terms of Market Capitalization and sector where they operate.

Among all the sectors, for the purpose of this research, the five companies chosen, all operate in the Materials sector. The Materials sector includes companies involved in the discovery, development, and processing of raw materials such as metals, chemical and forestry products. Furthermore, some energy sources, such as natural gas, fall into this category.

Since corporations operating in the Materials sector supply raw materials used for construction, and the price of raw materials is driven by the demand, the Materials sector is sensitive to both the business cycle and the fluctuations in supply and demand. Therefore, a strong economy is necessary for the well-being of the Materials sector.

Specifically, Flotek Industries Inc., Isagro S.p.A. and Showa Denko K.K., three of the five companies analysed, operate in the Chemicals subsector. The peculiarity here is that chemical raw materials are transformed into basic chemicals, intermediate or end products through a specific chemical process.

Executives in the Materials sector firmly believe in the relevance of organic growth, that is increasing the output and fostering sales internally avoiding many mergers and acquisitions, and in costs reduction. Furthermore, in a perspective where research and development are essential, innovation is a pillar of the Corporate Culture.

The huge presence of long-term incentive plans within remuneration packages for executives running companies in the Materials sector has been already noticed in 1997 by Kole. As a matter of fact, LTIPs based on restricted stock are common in the Chemicals subsector and in general in R&D-intensive companies (Murphy, 1999). Indeed, companies operating in the Materials sector heavily rely on long-term incentive plans and hence, comply with other Corporate Governance best practices.

Nevertheless, it has been observed by proxy advisory firms that the median executives’ pay in the Materials sector is lower than the median executives’ pay in other sectors such as the Insurance one. Indeed, companies in the Materials sector are less reliant on a highly specialized Top Management. Conversely, for instance, Insurance companies require executives with a strong technical background in the field of Finance, who for the peculiarity of their education, ask for higher payments.

In conclusion, the industry where a company operates matters for the analysis and the understanding of its executives' remuneration policies. This topic will be further analysed later on, in the paragraphs dedicated to each company part of the sample.

II.II Five Companies “in Search of an Author”

II.II.I Methodology

The purpose of this research is to compare five different companies, which are peers. Indeed, they all operate in the Materials sector and they are similar in size, where the size is measured, here, through the Market Capitalization of each firm.

More in detail, in order to find five companies, spread all over the world but with a similar Market Capitalization, five different Indexes have been analysed. All the five Indexes, S&P 600 Small Cap, FTSE 350 Small Cap, STAR, MSCI AC Asia Pacific Small Cap and MSCI Emerging Markets Latin American Small Cap, are small-cap segments which capture more local economic and sector characteristics.

The five peer companies chosen for the sample, show some differences when analysed. Such differences among the countries, the United States, the United Kingdom, Italy, Japan, and Brazil, are led to the different Corporate Governance background, which in turn, is led to a different development of the market conditions, the political context and the society as a whole.

This research explains the main features of each company, Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., and Gerdau Metalurgica S.A. Indeed, each paragraph includes a brief depiction of the geographical framework, a brief company’s presentation in terms of activities run, mission and vision, Culture, Corporate Governance structure and Share Capital and a detailed analysis of the Remuneration Policy. For each company, all the executives’ remuneration packages elements are examined with a specific focus on long-term incentive plans, which represent the kind of compensation which more enhances the link between executive pay and firm performance.

Then, through a graph, this research shows each company’s Remuneration Policy trend in the last five fiscal years. In fact, a comparison between the fixed remuneration also called base salary or just salary by some of the companies in the sample, demonstrates whether a company has an updated Remuneration Policy, which focuses on the improvement of the pay-performance sensitivity.

Furthermore, a second graph illustrates, for the Fiscal Year 2017, which has been the Chief Executive Officer's remuneration. Indeed, the CEO, who is at the top of the hierarchical pyramid within each organization, is the figure which deserves the greatest attention. Through a well-designed remuneration package, companies may align CEO's interests with the ones of shareholders, achieving a better performance.

Lastly, this research uses the Total Shareholder Return (TSR) as a performance indicator. The TSR's value is computed as the difference between a company's market share price at the end of the period, usually the fiscal year, and the market share price at the beginning of the period, that is the beginning of the fiscal year (Investopedia). The result is the delta market share price, to which the dividend paid must be summed up. In order to have a percentage which clearly indicates the reward earned by shareholders, this further value obtained has to be divided for the market share price at the beginning of the period. Hence:

$$[\ (Price_{END} - Price_{BEGINNING}) + Dividends\ ]\ /\ Price_{BEGINNING}$$

The computation is very easy and the only tricky value to find is the dividend paid. Indeed, the treatment of dividends is the challenge of calculating the TSR. Otherwise, the computation would be straight-forward, and the TSR would be the stock prices ratio. Nevertheless, since shareholders receive dividends, their effect has to be considered in the formula.

Concerning the data gathering, most of them are collected from the documents published by the companies. Indeed, listed companies are obliged to disclose information about executive remuneration. Later on, this research will show how the level of information disclosed is different country by country. Additionally, the more information a company discloses, the more transparent its business appears.

On the other hand, data used in the TSR computation are gathered from Yahoo Finance and from the Indexes web sites.

In conclusion, the more detailed is a company's Annual Report, the clearer is the analysis of its Remuneration Policy. Such concept is evident in the subsequent paragraphs.

II.II.I The United States, Flotek Industries Inc.

In the first Chapter, this research has deeply analysed the conceptual framework, underlying the executive remuneration. The greatest part of the literature about this topic comes from the United States. Indeed, for the purpose of this research, this paragraph will focus on the Company chosen for the sample.

However, the new SEC Regulation should still be mentioned. In 2006, the Securities and Exchange Commission enhanced the level of information disclosures. For instance, the disclosure of compensation consultants and peer companies used as a benchmark for remuneration packages setting process has become mandatory.

Furthermore, after the Enron-type scandals, in the United States, remuneration-related shareholder activism has increased through shareholder proposals. As a result of such shareholder activism, the mandatory adoption of say-on-pay in 2011, that is the shareholders' ability to actively vote during Annual General Meetings on executive remuneration, led corporations to improve their compensation practices. Indeed, the presence of institutional shareholders is associated with fairer executives' remuneration and more performance-related incentive plans (Conyon and He, 2004).

Flotek Industries Inc. is an American corporation listed in the S&P 600 Small Cap Index.

Nowadays, Flotek is a leading company developing and supplying chemistry products and services, to the Oil and Gas industries, and chemistry compounds to companies producing cleaning products, cosmetics, food, and beverages. Indeed, Flotek operates through two segments: Energy Chemistry Technologies (ECT), and Consumer and Industrial Chemistry Technologies (CICT).

Flotek's mission is to build trusted relationships with customers by delivering high quality standards. Indeed, the Company is committed to be the primary provider of chemistry solutions in the Materials sector in the United States. Furthermore, from a Corporate Governance perspective, the CEO has the credit for pushing the Company to have a diversified Corporate Governance structure.

John Chisholm is Flotek's CEO and Chairman of the Board of Directors since 2009. CEO Duality is hence a feature which sometimes characterizes American companies as well as Southern European.

Flotek Share Capital is composed of 56.863.000 shares.

Concerning Flotek's Remuneration Policy, the executive pay program is designed to attract, motivate and retain executive directors, who are essential for the Company's success. Additionally, the Board of Directors aims at aligning managers and shareholders' interests.

The Company has well-designed remuneration packages for the Top Management, which include:

i. Base Salary, reviewed annually accordingly to the selected Peer Group's practices.

ii. Annual Bonus. Participants to the short-term incentive plan receive an annual cash incentive based on Flotek performance. The performance criteria have been expanded from a single financial measure to two financial measures and an individual KPI established for each beneficiary. Allocation of the total target payment is as follow: 60% based on the Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA) target, the so-called "EBITDA Bonus"; 20% based on the Revenue target and 20% based on performance against individual goals, the "Goal Bonus".

If the EBITDA Bonus threshold level, \$27.5 million, is achieved, 50% of the award is paid. If the EBITDA Bonus target level, \$32.0 million is achieved, 100% of the award is paid. If the EBITDA Bonus cap level, \$38.0 million is achieved, 200% of the award is paid.

If the Revenue Bonus threshold level, \$300.0 million, is achieved, 50% of the award is paid. If the Revenue Bonus target level, \$335.0 million is achieved, 100% of the award is paid. If the Revenue Bonus cap level, \$370.0 million is achieved, 200% of the award is paid.

iii. Stock Awards, that is an LTIP.

iv. All Other Compensation, including Vehicle Allowance, Company Provided Housing and Services and Consulting Contracts.

v. Severance.

The implementation of the long-term incentive plan deserves particular attention. Indeed, the information disclosed in the United States is very detailed. During the Flotek's Annual General Meeting held on the 27^{th} of April 2018, shareholders approved a new LTIP which makes 3.000.000 shares of the Company's Common Stock available for the granting of awards.

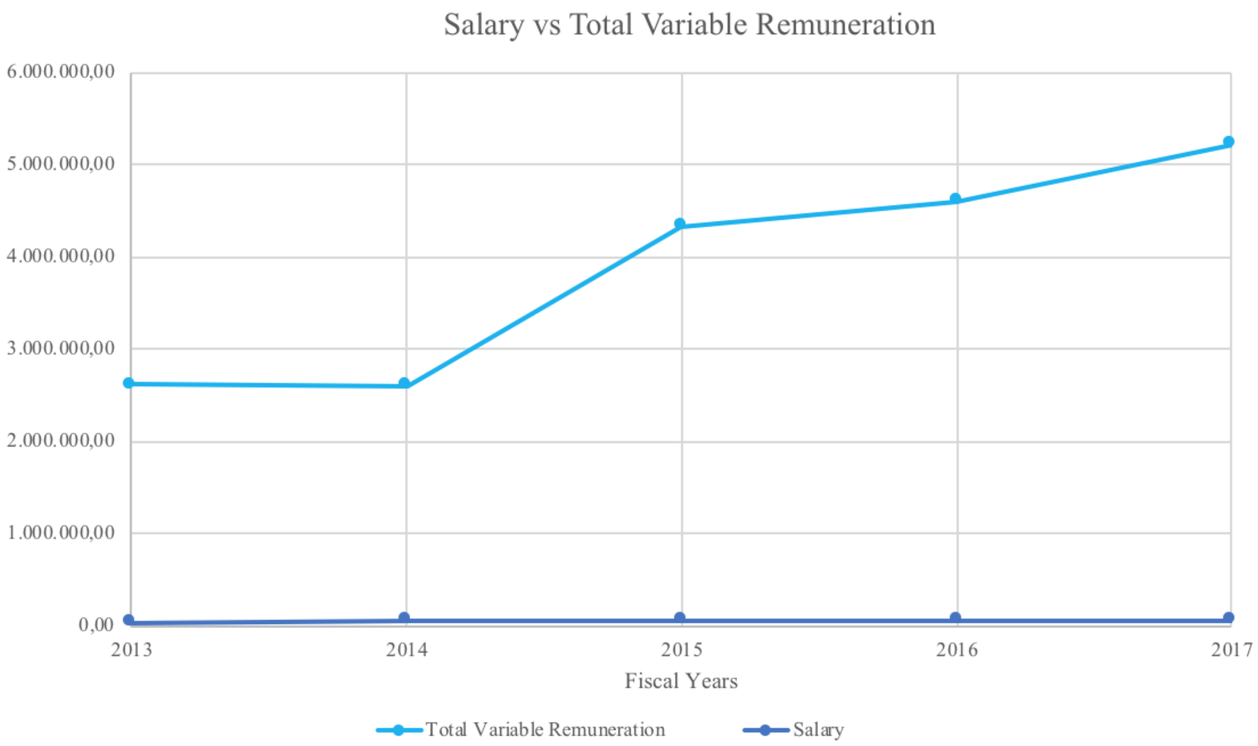
The Board of Directors, that is the Plan administrator, clarifies that the purpose of the Plan, as the purpose of the Remuneration Policy as a whole, is to assist the Company in:

i. Attracting and retaining the best available employees for positions of substantial responsibility.
ii. Motivating employees by providing additional incentives to the Top Management, including providing financial incentives for individual performance.
iii. Promoting the success of the Company's business interests
iv. Increasing the Top Management's attention in the Company, therefore aligning their interests with those of shareholders.

Flotek's Plan is peculiar for being an "Omnibus" Stock Plan. Indeed, American companies implement LTIPs allowing the Plan administrator to choose which kind of financial instruments may be granted. As a result, in the United States, under the same long-term incentive plan, the Board of Directors may provide for the issuance of restricted stock, performance shares, stock options and stock appreciation rights.

Flotek's Board of Directors has implemented for the 2018 a new LTIP whose 60% of the award is paid in performance shares. The KPIs chosen for the performance shares-based part of the Plan are the Total Shareholder Return (TSR) for the first 30% and the Return on Tangible Assets (ROTA) for the remaining 30% of the award. Flotek Industries should perform at least the 50^{th} percentile in the TSR of the peer companies among the Russel 2000 Index, that is the target level.

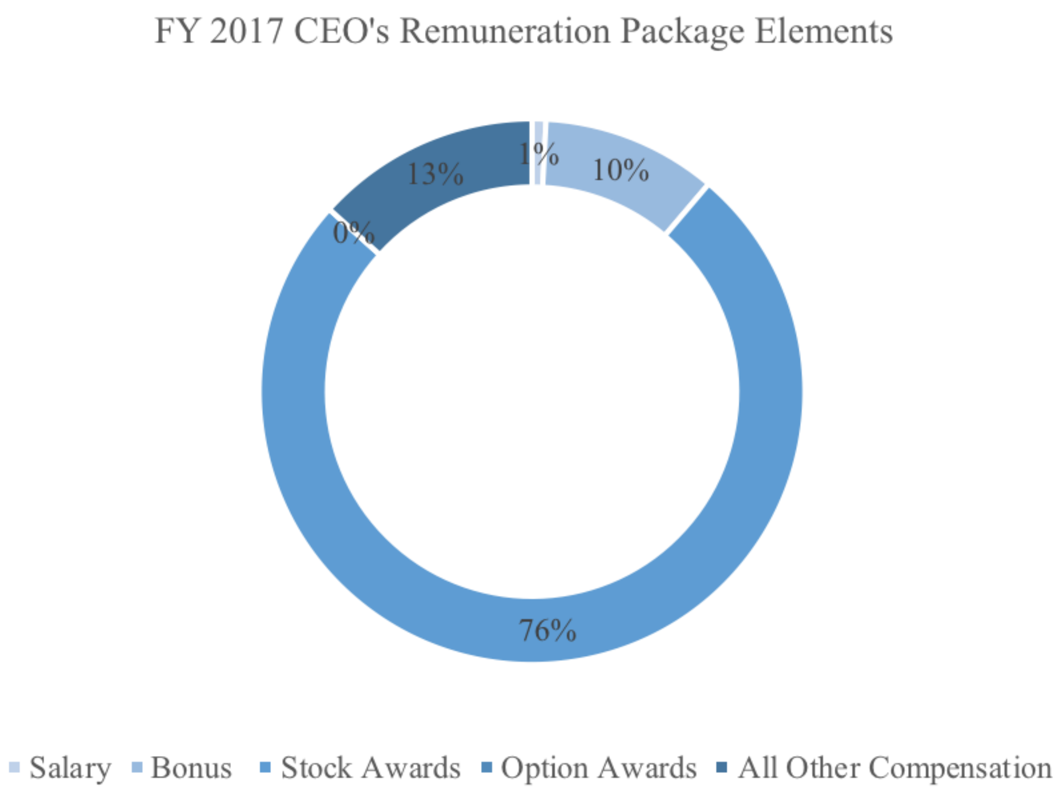
Additionally, the Board of Directors has implemented different guidelines relative to both the minimum vesting period and the claw-back mechanisms. Indeed, the 40% of the award granted in restricted stock has a minimum vesting period of one year. The only exception occurs in case of a Change-in-Control. Here, the Board of Directors has the right to reduce the vesting period.



Author's analysis based on data provided by Flotek Industries Inc.

Data in US Dollars

Salary	Bonus	Stock Awards	Option Awards	All Other Compensation
50.000,00	631.455,00	4.584.463,00	0,00	810.000,00



Author's analysis based on data provided by Flotek Industries Inc.

Data in US Dollars

What is evident from the graphs is the relevance of variable remuneration in American pay packages. The variable remuneration accounts for more than a half of the total Chief Executive Compensation. Indeed, researchers believe that the increase in American executive remuneration is due to the implementation of long-term incentive plans.

However, Flotek Industries is an exception to the trend. Indeed, the table above shows how the Company has implemented a LTIP based on restricted stock and performance shares without issuing option awards. Jensen, Murphy and Wruck (2004) have observed an increase in the US executives' remuneration due to the explosion in options grants. Nonetheless, American corporations improperly perceive the cost of granting options as zero. This research has already explained how the cost of granting an option corresponds to the opportunity cost the company gives up by not selling the option on the market. Since executives do not value options as much as an outside investor does, because they are not diversified, and they cannot hedge the risk by short-selling, the cost for the company results higher than the benefit for the beneficiary of the option award.

A last point for this research analysis, is the computation of Flotek's Total Shareholder Return (TSR). Considering that the Company has not paid dividend, the TSR for the Fiscal Year 2017 equals -51,26%

The negative performance achieved during the last fiscal year is due to disruption in the citrus supply caused by Hurricane Irma.

$$(4{,}66 - 9{,}56 + 0) / 9{,}56$$

Data Source Yahoo Finance and NASDAQ
Data in US Dollars

II.II.II The United Kingdom, Lonmin Plc.

Conversely to many countries in Continental Europe, The United Kingdom has a long history in Corporate Governance. Indeed, in 2017, it has been twenty-five years since the publication of the Cadbury Report, that is the first UK Corporate Governance Code. In the United Kingdom, the quality of Corporate Governance has continued to improve over the time and nowadays, the Code's "comply or explain" approach has allowed British corporations to respond effectively to the evolving environment trends.

The latest version of the UK Corporate Governance has been implemented in 2016, setting new standards for optimal Corporate Governance practices related to board leadership and effectiveness, remuneration, accountability and relations with shareholders. More specifically, the Code includes both general principles and more specific provisions aimed at encouraging companies to develop transparent and formal remuneration policies for the Top Management. The quality improvement of disclosed information noticed by proxy advisory firms is due to the compliance with the Code. Since Annual Reports and additional documents should be publicly disclosed, corporations' business strategies have started focusing more on the future, and hence on shareholder value creation in the long-run horizon.

Furthermore, on February 2017, the Financial Reporting Council announced the willingness to further enhance the UK Corporate Governance Code, giving more space to Corporate Culture and Corporate and Social Responsibility.

During the same year, 2017, Grant Thornton, a leading consulting firm, conducted a research whose evidence is positive. In fact, in 2017, 66% of UK companies announced full compliance with the Code, 93% of UK companies provided high-quality remuneration policies disclosures, 37% of UK companies made no use of non-financial KPIs for performance-related remuneration, 91% of the UK companies included claw-back provisions for both short and long-term incentive plans, which allow the company to recover amounts already paid, 96% of UK companies' Annual Reports referred to the link between executives' compensation and the business strategy.

The UK Corporate Governance Code specifies some features executive remuneration should have.

On one hand, concerning the short-term incentive plans implementation:

«*Remuneration incentives should be compatible with risk policies and systems. Upper limits should be set and disclosed. The remuneration committee should consider whether the directors should be eligible for annual bonuses and / or benefits under long-term incentive schemes.* » (UK Corporate Governance Code, Schedule A).

In fact, although from the analysis of the CEO's remuneration package in the American company, Flotek Industries, what is clear is the huge relevance of the equity-based LTIP, in the United Kingdom, bonuses are still very popular, and hence an accurate design of such schemes is absolutely required (Bruce, Skovoroda, Fattorusso and Buck, 2007).

On the other hand, concerning the long-term incentive plans implementation:

«*For share-based remuneration, the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company, subject* *to the need to finance any costs of acquisition and associated tax liabilities. » (*UK Corporate Governance Code, Schedule A).

Performance share schemes still are the most widespread kind of LTIP with a performance period typically of three years. However, shareholders start expecting a further holding period of two years. Therefore, because of shareholders activism, the combination of vesting, or performance, and the holding period is now on average five years.

Furthermore,

«*Executive directors' remuneration should be designed to promote the long-term success of the company. Performance- related elements should be transparent, stretching and rigorously applied » (*UK Corporate Governance Code, Main principle D.1).

However, in the past, estimates of pay sensitivity to firm performance in UK enterprises has resulted lower than those observed in the United States (Bruce, Skovoroda, Fattorusso and Buck, 2007).

As a matter of fact, although all the improvements and the implementation of the aforementioned Code, in 2018 the Financial Times have reported some issues with the Corporate Governance in the UK. Firstly, the presence of an independent Board is still far from being widespread among British corporations. Furthermore, the vesting period for both short and long-term variable remuneration is still not sufficient to enhance the pay-performance sensitivity.

In this framework, Lonmin Plc. is the company, listed in the FTSE 350 Small Cap Index, analysed. Lonmin is a leading producer of Platinum Group Metals, hence operating in the Materials sector. Those metals are needed for many industrial applications.

Lonmin is an old factory, founded in London in 1909 which conducts the business in a socially and environmentally responsible and sustainable way. As the other companies analysed by this research, Lonmin has a value-based culture which focuses on safe work, continuous enhancements, and high performance. Among the Company's value, integrity, honesty and trust, transparency and respect are the most valuable.

Concerning the Company's governance structure, Lonmin is led by a Board of Directors composed of three executives and six non-executive directors. According to the Chairman of the Board, Brian Beamish, the Top Management runs Lonmin following the Board directives.

Moreover, the Chief Executive Officers, Ben Magara, is in charge of providing leadership to the Management. Lonmin is the only company within the sample of this research where CEO Duality is not a feature. Therefore, Lonmin is structured accordingly to best Corporate Governance practices.

According to the Chairman of the Board, Brian Beamish, the Top Management role is running Lonmin following the Board directives.

Furthermore, the ownership of the Company's shares is concentrated in a number of institutional shareholders, a feature which helps to prevent the Management from pursuing its best interest. The total Share Capital amounts for $182 million, divided into 282.780.000 outstanding shares.

Concerning the Company's Remuneration Policy, the Board of Directors aims at:

i. Attracting and retaining people of the calibre necessary to deliver the Board's strategic plans and provide leadership to the Management team.
ii. Incentivising the Management to achieve strategically-aligned goals which create shareholder value.
iii. Promoting a system which encourages safety, sustainability and social responsibility.
iv. Aligning interests by delivering a significant portion of the reward in shares.
v. Delivering outcomes which are fair and incentivise the relationship between pay and performance.

Furthermore, the Remuneration Committee ensures that the Company's Remuneration Policy is aligned with the FTSE practices.

More specifically, remuneration pay packages are structured as follow:

i. Base Salary. Offering market-competitive levels of fixed compensation helps the Company to attract and retain skilled managers. Indeed, the salary is paid in cash monthly. The level reflects both the employee's skills and experience and is set based on peer companies' practices.

ii. Benefits. Lonmin offers a wide range of perquisites including the Company's vehicle, private medical insurance, income protection insurance, life insurance, professional advice, security

iii. Retirement benefits. Contributions to pension schemes which may not exceed the 20.52% of the Base Salary.

iv. Annual Bonus. The two short-term incentives aim a creating a strong performance culture. They are the "Balanced Scorecard Plan" – BSC - and the "Annual Share Award Plan" - ASAP. Respectively, the first award is paid in cash while the second one in shares. Malus and claw-back provision are provided by the Company. Moreover, for the BSC, the KPIs are set at the corporate level with a weight of 80% (Safety, Transformation, Production and Financial) and are linked to personal objectives for the remaining 20%. Above the details provided by the Company for the Fiscal Year 2017:

Strategic Element	Metric	Target performance	Actual performance	Relative % weighting of bonus
Safety:				
Improvement in lost time injury frequency rate (LTIFR),	Percentage improvement on FY2016 LTIFR	4.14	4.52	10.0
Fatalities	Multiplier (0 = 2x, 1 = 1x, 2 = 0.5x, 3 = 0.25x, 4 or more = 0x and no payment)	1	5	10.0
Transformation:				
SLP	Assessment against SLP targets	2	1.6	10.0
Living conditions	Subjective assessment of progress against the Employee Accommodation Strategy	2	2.5	5.0
Production:				
Refined Pt oz produced	Refined oz of finished metal	680,000	688,000	10.0
Mined saleable Pt oz	Refined oz of finished metal	693,000	651,000	10.0
Productivity	Square metres per total mining employee – G2 shafts	6.5	5.8	5.0
Instantaneous recoveries	Percentage of contained metals recovered	84.9%	86.4%	5.0
Financial:				
Unit costs per PGM oz	Cost (in Rand terms) per PGM oz produced (6E basis)	10,850	11,761	10.0
Free cash flow	Trading cash flow minus capital expenditure and less minority dividends for FY2017	USD 0	USD (99m)	5.0
Sub-total of corporate metrics				80.0
Personal	Progress against personal objectives Ben Magara			20.0

Lonmin Plc., Annual Report, Fiscal Year 2017.

v. LTIP. The long-term incentive plan aims at aligning the Management and shareholders' interests by linking the reward, paid in the Company's shares, to the long-run performance. The award vests in three tranches after three years after the grant date, meaning that the Plan lasts five years. Furthermore, the vesting of the award is based on financial, operational and share price-based measures set by the Remuneration Committee. The KPIs are aligned with the long-run strategy implemented by the Company. In detail, the performance is measured through a combination of relative TSR and return-based targets. The Company discloses the levels to be achieved:

Company's Average Annual CROIC Performance	CROIC Factor
Less than 10%	0 x
10% or more but less than 11%	0.2 x
11% or more but less that 12%	0.5 x
12% or more but less that 13%	0.7 x
13% or more	1 x

Company's Annualised Average TSR	RTSR Factor
Less than Median TSR	0 x
Median TSR	0.5 x
Median TSR + 5% p.a.	0.7 x
Median TSR + 10% p.a. or greater	1 x

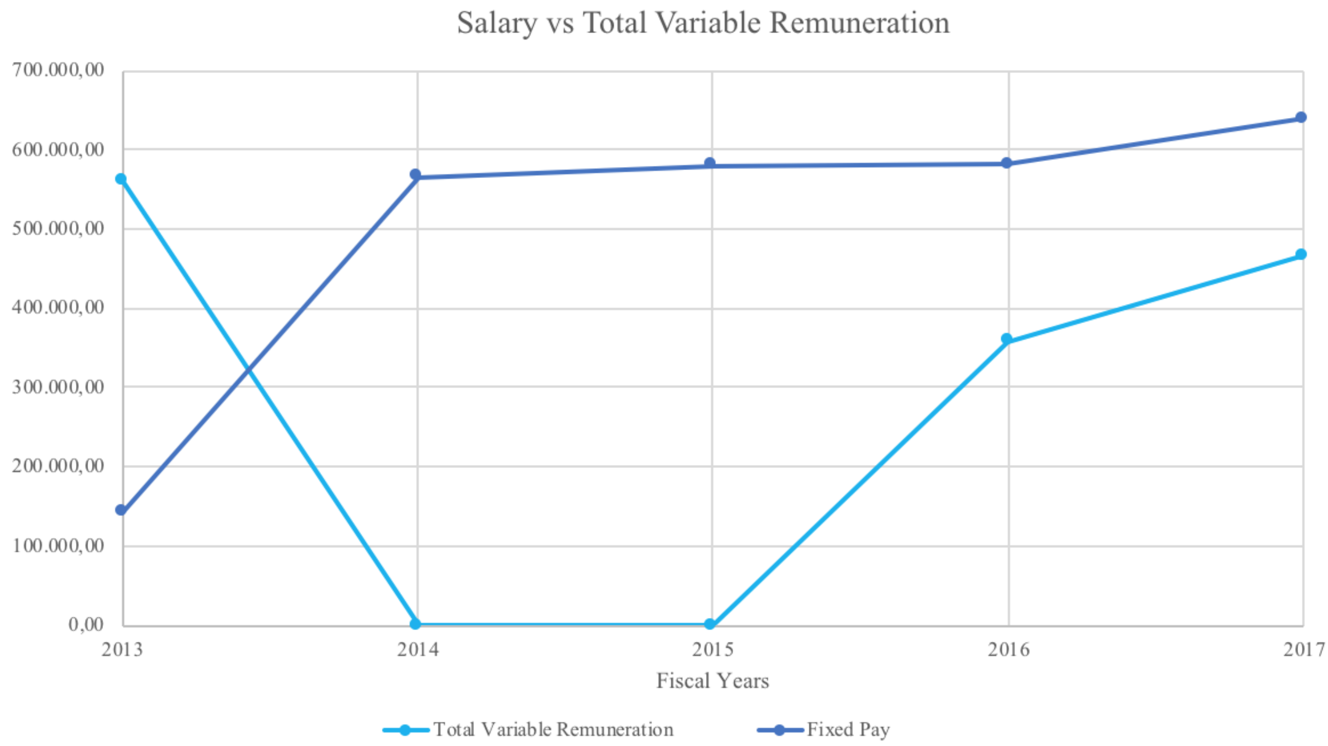
Lonmin Plc., Annual Report, Fiscal Year 2017.

On one hand, the CROIC is the Cash Return on Invested Capital, averaged over three financial years. It is a measure of the Net Operating Profit After Tax without the impact of depreciation and impairment, compared to the invested capital.

On the other hand, the relative Total Shareholder Return, which ensures that executive remuneration reflects actual returns delivered to shareholders.

Lastly, the Peer Group to which Lonmin's remuneration is linked is made of four companies operating in the Materials sector: Anglo

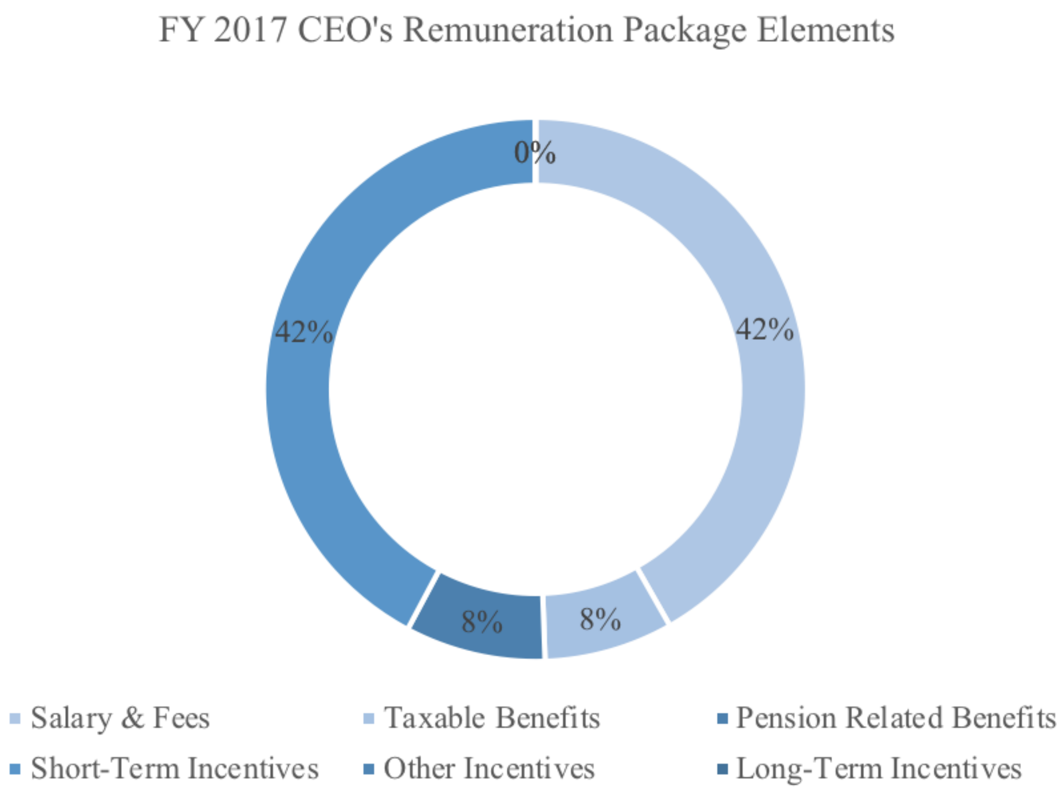
American Platinum, Impala Platinum, Northam Platinum, Royal Bafokeng Platinum.



Author's analysis based on data provided by Lonmin Plc.

Data in British Pound

Salary & Fees	Taxable Benefits	Pension Related Benefits	Short-Term Incentives	Other Incentives	Long-Term Incentives
462.150,00	84.868,00	92.430,00	466.933,00	0,00	0,00



Author's analysis based on data provided by Lonmin Plc.

Data in British Pound

What is evident from the last graph, is the relevance of the annual bonus. Indeed, at the beginning of this paragraph, this research has underlined how UK companies are still tied to a performance-related remuneration which, in turn, is tied to the short-term horizon.

Furthermore, for a short period of two years, the Board of Directors preferred achieving the Remuneration Policy's purposes by increasing the percentage of the fixed remuneration within the Chief Executive Officer pay package. Conversely, since 2016, both the base salary and the total amount of variable remuneration have started increasing.

In brief, since within remuneration packages all the elements are balanced, Lonmin's Remuneration Policy is very well-designed. The absence of LTIPs and equity-based incentives in the second graph is due to the fact that nothing vested during Fiscal Year 2017, although an LTIP is clearly implemented by the Company.

In conclusion, during Fiscal Year 2017, no dividends were paid, and hence the Total Shareholder Return amounted for -58,20%, being extremely low:

(23,50 – 56,22) / 23,50

Data Source Yahoo Finance
Data in British Pound

Although Lonmin's Remuneration Policy and Corporate Governance structure are both well-implemented, further improvement should be proposed in order to overcome the underperformance. In fact, the Management should respond, at least partially, for macroeconomic shocks which occurs independently from its actions and decisions but on which an influence can be exercised.

II.II.III Italy, Isagro SpA

Different trends have been characterizing Continental European companies during the last decades. While one of the companies' features in the UK and US, is the presence of a dispersive ownership, French, Spanish, Italian, German companies show a high ownership concentration, and often the majority shareholding is held by a family (Barontini and Bozzi, 2009). Concentrated ownership has two competing consequences. On one hand, dominant shareholders are able to control the Management. On the other hand, ownership concentration may create new agency issues due to the misalignment of interests between dominant and minority shareholders (Enriques and Volpin, 2007).

Nowadays, an additional widespread feature is the presence of institutional investors, that is mutual funds, hedge funds, insurance companies (Croci, Gonenc and Ozkan, 2012). Institutional investors often own a huge percentage of a company's Share Capital. Owning block shareholdings may help mitigate free-riding issues due to ownership dispersion. As a result, agency costs may be reduced (Croci, Gonenc and

Ozkan, 2012). Furthermore, institutional ownership may benefit minority shareholders encouraging the Management to act in every shareholder's best interests.

After the Financial Crisis, corporations understood the importance of Corporate Governance: weaker Governance structures, in terms of both Board of Directors and shareholding, produce agency costs which harm firm's performance (Barontini and Bozzi, 2009). Indeed, significant corporate law reforms have been enacted in order to strengthen Governance mechanisms, empower investors, enhance disclosure requirements against abuses, and foster public enforcement (Enriques and Volpin, 2007). Since minority shareholders in Continental Europe companies need protection, because of the ownership concentration phenomenon, special reforms have been endorsed for the matter.

Lastly, Croci, Gonenc and Ozkan (2012) have observed an increase in executives' remuneration in Continental Europe. Such increase shows the relevance bonuses, perquisites, and incentive plans have acquired in pay packages recently.

In this framework, Isagro S.p.A. is an Italian company operating in the Chemicals subsector.

Established in 1993 and listed on the STAR segment since 2003, Isagro invests in new molecules and in the improvement of active substances without having a huge impact on the environment. Indeed, Isagro is an innovative company investing in research and development with four production facilities in Italy and one in India.

Concerning Isagro's Business Model, the "Global Independent Originator" Business Model has been further strengthened during the last fiscal years. Isagro has indeed enhanced the new business area dedicated to the improvement and usage of the Company's intellectual property rights. Therefore, Isagro produces both intermediary and end chemical products and basic proprietary chemicals which are provided on the market to be mixed with third parties' products.

Isagro's main strength is the capability to develop and patent new chemicals, together with the know-how and experience in assessing its products' effectiveness. Furthermore, in 2004, Isagro Share Capital has been increased through the issuance of new shares called "Growth Shares". As a matter of fact, the Company's mission is offering customers innovative chemical products which are environment-friendly. Additionally, Isagro seeks to compete on the market, increase customers' satisfaction, create shareholders value, improve skills, and enhance its employees' professional growth. Indeed, the Company discloses a Non-Financial Report about Isagro's Corporate and Social Responsibility practices.

During the Fiscal Year 2017, Giorgio Basile has been confirmed both CEO and Chairman of the Board, hence Isagro is a company where CEO Duality exists. As this research as explained in the aforementioned Chapter, CEO Duality has some implications in remuneration packages setting process. Nevertheless, CEO Duality is a common feature for Italian companies.

In Fiscal Year 2017, Isagro's Share Capital amounted to EUR 24.961.207,65 divided into 24.549.960 Ordinary Shares and 14.174.919 Growth Shares.

Here the details about Isagro's Share Capital structure:

	No. of Shares	% of Share Capital	Listed with the indication of the market / Unlisted
Total Shares of which:	38.724.879	100%	MTA STAR (Borsa Italiana S.p.A.)
- Ordinary Shares	24.549.960	63%	MTA STAR (Borsa Italiana S.p.A.)
- Growth Shares	14.174.919	37%	MTA STAR (Borsa Italiana S.p.A.)
Multiple Voting Shares	/	/	/
Limited Voting Shares	/	/	/
Non-Voting Shares	14.174.919	37%	MTA STAR (Borsa Italiana S.p.A.)

Isagro S.p.A. "Corporate Governance and Ownership Structure Report", Fiscal Year 2017.

Isagro's Remuneration Policy has been approved already in 2013 and it is consistent with Borsa Italiana S.p.A. – the Italian stock exchange – recommendations. Every year the Nomination and Remuneration Committee updates the Company's

Remuneration Policy in order to have it aligned with the most recent trends and market's best practices.

In the aforementioned Chapter, this research has shown how the Remuneration Policy may be implemented in a Human Resource or Agency Theory perspective. Isagro's Board of Directors has implemented the Company's Remuneration Policy accordingly to both perspectives. Indeed, the Remuneration Report, Paragraph 1.4, states that Isagro's Remuneration Policy is aimed at:

i. Attract, retain and incentivize the Management;
ii. Align the Management and shareholders' interests;
iii. Promote shareholders' value creation in the long-run horizon.

Concerning executives' remuneration, remuneration packages are set accordingly to best practices adopted by peer companies – small and middle listed companies operating in the Chemicals subsector - and they include:

i. A fixed annual component.
ii. A variable annual component, linked to the achievement of performance objectives. Such objectives are measurable and designed to create shareholders' value. The Board of Directors sets in advance strategic and financial criteria which are in line with the Annual Budget. Each goal has a specific weight in determining the performance achievement and a threshold, a target, and a cap level are set by the Company.

    In addition, the variable annual component amounts for a percentage between the 10% and the 35% of the fixed remuneration. There is no deferral period and no malus or claw-back clauses are included in the design of the annual bonuses.
iii. Fringe benefits such as the Company's car and an insurance policy, the so-called "Directors&Officers".
iv. One-off bonuses may be granted under special circumstances.
v. "Restricted Shares and Performance Shares Plan 2018-2021". For the very first time, Isagro, in line with Corporate Governance best practices and

with market standards, opted for the implementation of a long-term incentive plan.

The Plan aims at retaining skilled employees, involved in the Company's "Industrial Plan" implementation, at achieving long-run objectives, and at enhancing the Top Management team work. Indeed, the Board of Directors, which is the Plan administrator together with the Nomination and Remuneration Committees, firmly believes in the relevance of the Plan for the alignment of Management and shareholders' interests.

The Plan lasts four years, form the first of January 2018 until the thirty-first of December 2021. Beneficiaries of the Plan are nine executive directors whose actions and decisions impact the Company's performance. The financial instruments assigned are the Company's Growth Shares whose issuance determinates a dilutive effect on the Company's Share Capital. Moreover, the Growth Shares issuance is subject to both the existence of an employment agreement between the Company and the Beneficiary until the end of the Plan and the achievement of some performance criteria. Indeed, the financial instruments granted are both Restricted Shares, amounting to the 50% of the total award, and Performance Shares, amounting to the remaining 50% of the total award.

Additionally, the maximum number of financial instruments which may be granted amounts for one million and the financial instruments' value is set as the average closing price of the Company's shares during ninety days before the issuance date.

The longer is the vesting period, the better shareholders may gather information about the firm's performance during the implementation of the plan. Here, the maximum vesting period, four years, differs from the minimum vesting period, only two years. Indeed, the Restricted Shares start vesting at the 2019-year-end, and they are assigned to the Plan's beneficiaries in three tranches until the end of the plan. On the other hand, the Performance Shares vests over a period of four years and are granted in cliff during the Fiscal Year 2022.

Concerning the performance objectives to be achieved by the Plan's beneficiaries, they are financial KPIs with a weight of 25% each. They are Isagro's Ordinary Share Value, EBITDA / Revenues ratio, Net Working Capital / Revenues ratio and Net Financial Position / EBITDA ratio.

Some clauses are provided by the Plan administrator in case of employment termination. In a bad leaver hypothesis, that is misconduct of one of the beneficiary, the Plan's beneficiary loses the right to receive the award. Moreover, in the hypothesis of Change-in-Control, that is a hostile takeover such as a merger or acquisition, the Board of Directors may accelerate the award vesting even without being authorized by the shareholders. In the latter case, the Plan's beneficiaries receive the award even without having achieved the performance conditions set when the Plan has been implemented. The only condition to receive the award the Plan's beneficiaries are subject to in case of a Change-in-Control is the continuation of their employment with the Company which has taken over Isagro S.p.A.

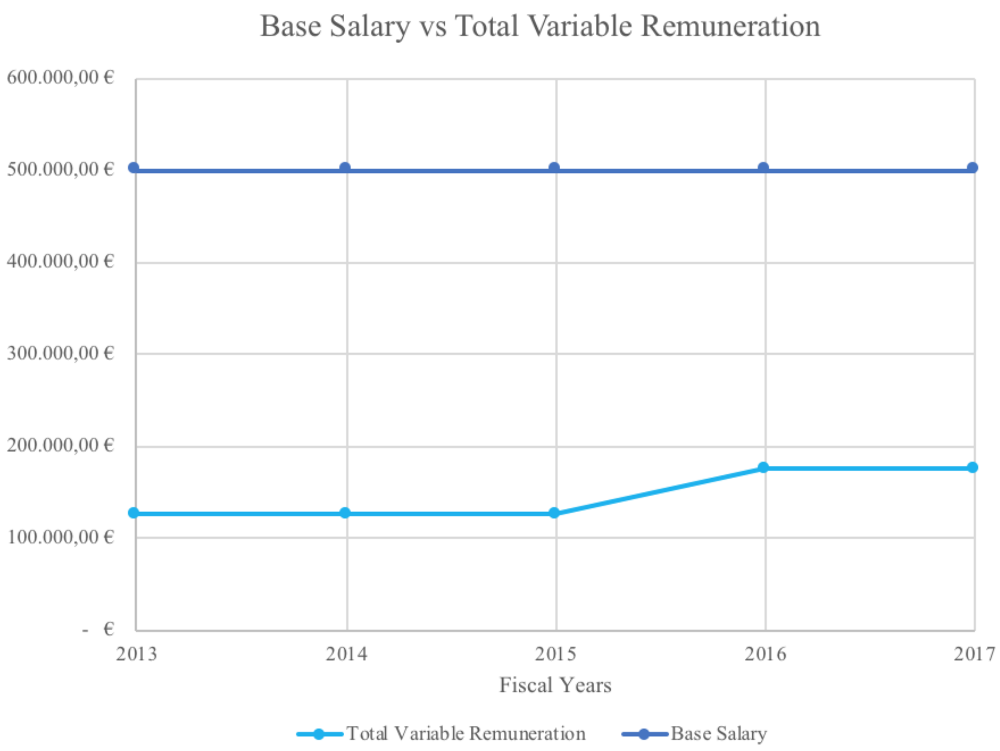
In the light of the above, some points might be made. Firstly, the annual bonus lacks the deferral period, which helps discourage the Management from conducting myopic behaviors (Melis, Carta and Gaia, 2010). Then, the Board of Directors does not include claw-back and malus provisions which allow the Company to ask back for the award in case of executives' misconduct. Isagro justifies the lack of such provisions with the strong presence of the Basile family in the ownership structure. However, the presence of a family both in the committees and in the ownership should not prevent the Company from including provisions which help reduce opportunistic behaviors.

Furthermore, the Company does not clearly indicate any KPI for the annual bonus and does not specify the threshold, target and cap levels for long-term incentive plan KPIs. The lack of a threshold, target and cap level implies a vague specification of the "incentive zone" which is the driver of the incentivizing effect of long-term incentive plans.

Concerning the nature of the KPIs included, Isagro does not provide for KPIs other than the financial ones, which is not a best practice considering the relevance that Corporate and Social Responsibility has nowadays.

In conclusion, although Isagro's Remuneration Policy should be further improved in order to be even more in line with Corporate Governance best practices and proxy advisory firms' recommendations, it is implemented accordingly to market standards. Concerning the "Restricted Shares and Performance Shares 2018-2021", some features such as KPIs specification should be enhanced in order to have pay and performance further aligned.

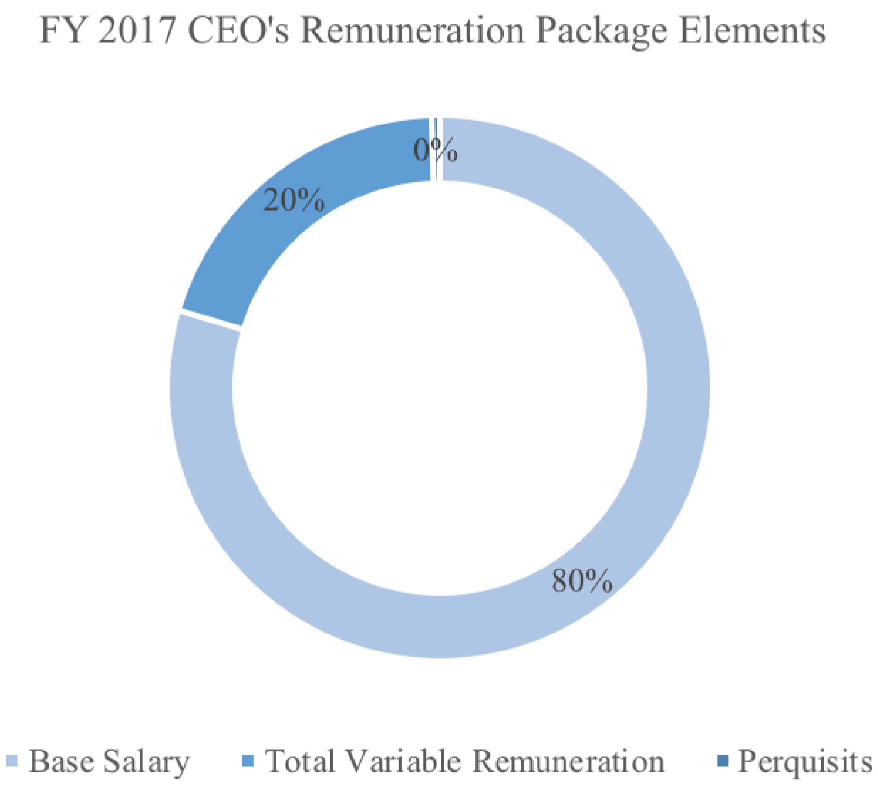
For the purpose of this research, by analysing the second section of Isagro's Remuneration Report, showing the weight of different elements in the Chief Executive Officer, Giorgio Basile, remuneration package, and evaluating the trend of his Total Variable Remuneration compared to Base Salary, is made possible.



Author's analysis based on data provided by Isagro S.p.A.,

Data in Euro

Base Salary	Total Variable Remuneration	Perquisits
€ 500.000,00	€ 125.000,00	€ 3.024,00



Author's analysis based on data provided by Isagro S.p.A.,

Data in Euro

What is clearly evident is the lack of changes in Isagro's Remuneration Policy during the last five fiscal years. Furthermore, the Total Variable Component, compared to the Base Salary, does not amount even for the half of the CEO's remuneration package.

However, although a lack of changes is typical in Italian companies since an equity-based incentive plan has been implemented this fiscal year, Isagro S.p.A is an evidence of the wave of improvements in Corporate Governance policies in Continental Europe markets.

The last point for this research analysis is the computation of Isagro's Total Shareholder Return (TSR). Considering that the Company has not paid dividends, the TSR for the Fiscal Year 2017 equals 53,57%.

$$(1{,}72 - 1{,}12 + 0) / 1{,}12$$

Data Source Yahoo Finance and Borsa Italiana S.p.A.
Data in Euro

II.II.IV Japan, Showa Denko K.K.

Japanese corporations have started disclosing some information about executive compensation later in 2009. Indeed, the Japan Cabinet Office Ordinance on Disclosure of Corporate Affairs was revised only in 2010 when the disclosure of individual remuneration data has become mandatory for listed companies with executives earning more than a hundred million Japanese Yen (Sakawa, Moriyama and Watanabel, 2012). In companies where managers receive less than a hundred million Japanese Yen, the information concerning executive pay is disclosed only as an aggregate amount of total remuneration (Ganu, 2014).

The lack of a strong regulatory framework and monitoring by external analysts, the lower disciplinary enforcement from the managerial labour market, and the opaque information environment (Lee, 2014) in Japan are due to many different factors. Firstly, the Country is traditionally regarded as having a "relationship-oriented" system, which is different from the "market-oriented" system characterizing Western companies. Indeed, in Western companies outside directors and independent committees are in charge of monitoring. However, the tide is turning and after the so-called Big Bang deregulation, that is the deregulation of the Japanese financial system, and some Corporate Governance reforms, the Japanese corporate structure may be regarded as a "transition" system (Sakawa, Moriyama and Watanabel, 2012). In fact, the presence of independent directors in remuneration committees as the presence of institutional investors in the ownership structure may enhance the relationship between executives' pay and firm performance.

In the Managerial Power Theory perspective, which this research has already analysed in the aforementioned Chapter I, both independent directors and institutional investors have better monitoring influence and hence the Management is less powerful, and the pay-performance sensitivity is enhanced.

Kin-Wai Lee (2014) found out that in East Asian economies and therefore in Japan, the level of executives' remuneration is positively associated with the Management's power and the link between pay and performance is weak. Here, the Managerial Power Theory seems to be strongly supported by empirical evidence. Nevertheless, as explained before, the negative association between excessive CEOs remuneration and enterprise performance may be mitigated by stronger corporate structures.

So far, this research has explained why the Management should be rewarded through both fixed and variable payments. Indeed, since a competitive market for talented managers exists, the fixed element in remuneration packages should be designed to pay a competitive salary for the position held within the organizational hierarchy. On the other hand, remuneration packages should include both an annualised and a long-term variable element. Additionally, the short-term measures should be linked to the company's business plan developed in a long-term horizon and should aim at the shareholders' value creation. Since the abolishment of Japanese legal prohibitions on granting stock options led to the United States' influence, the matter for Asian corporations is the implementation of LTIPs for retention purpose instead of shareholder value creation. As a matter a fact, the Top Management in Asia, often receive pay without an adequate performance to justify it. Kothuis and Chua (2014) believe that since talented managers are coveted from many companies in the market for managerial talents, the failure in rewarding executives who perform well, for the actions and decisions they have made, may further weaken the company performance.

Therefore, an additional area of concern is the remuneration packages design: how much of variable pay compared to fixed pay should executives receive? How much cash and how much equity-based awards should be included in pay packages? Ganu (2014) observed that Asian companies often provide a great amount of variable remuneration. Indeed, Board of Directors in Japan, prefer more flexible pay elements which can be adjusted based on the enterprise performance. Nevertheless, variable remuneration in

Asia consists mainly in cash-based annual bonuses. Indeed, Asian corporations are less willing than their Western counterparts to implement equity-based LTIPs. Moreover, although many companies now understand that non-financial performance criteria may have a better incentivizing effect in a very competitive environment such Asia is, the most widespread Key Performance Indicators for both short and long-term awards are financial: Net Profit and Total Shareholder Return (TSR).

Lastly, a difficult decision for Asian remuneration committees is the one concerning the group of peer companies to have as a benchmark for the implementation of executive remuneration policies. Indeed, such decision is not so straightforward in Asia since the number of corporations operating in the same sector and similar in size is limited in each Asian country.

In conclusion, nowadays the background is improving. Since both investors and regulators are asking for more detailed disclosures on pay levels, remuneration packages design and Top Management performance assessments, the focus on executives' remuneration policies is increasing. Proxy advisory firms suggest Asian companies a split in remuneration reports where a first section should introduce future changes in remuneration practices and a second section should explain the implementation of the policy for the reported fiscal year. Then, an additional suggestion is enhancing the focus on equity-based remuneration. As a result, Asian companies will start following the pattern of Western companies where information disclosures are undoubtedly more encouraged.

In a constantly improving emerging market, Showa Denko K.K. is the Japanese company included in this research' s sample. It is listed in the MSCI AC Asia Pacific Small Cap Index.

Showa Denko K.K., established in 1939 by the merger of Nihon Denki Kogyo K.K. and Showa Hiryo K.K, is a Japanese leading company in the Materials sector, operating in six major segments: petrochemicals, chemicals, electronics, inorganics, aluminium, and others – building materials. The Company's vision is providing products and services which are useful and safe, exceeding customers' expectations and hence increasing the shareholder value and contributing to the sustainable growth of both the Japanese market and society.

Research and Development are the focus of attention for the Company. Indeed, in 2016, Showa Denko implemented the "Project 2020+" by investing sixty billion of Japanese Yen. In fact, in January 2018, the Company received the "The Clarivate Analytics 2017 Top 100 Global Innovators" award. Clarivate Analytics, that is the Intellectual Property & Science business of Thomson Reuters, selected the top 100 innovation-leading companies and organizations.

Furthermore, Showa Denko aims at strengthening its Corporate Governance. In December 2015, the Company established the "Corporate Governance Basic Policies" promoting the dialogue with all its stakeholders and creating shareholders value. Indeed, Showa Denko is promoting the Management's trustworthiness, effectiveness, and transparency through enhanced Corporate Governance practices.

Since 2017, the Chief Executive Officers is Kohei Morikawa, previously Head of the Showa Denko Technology Division. The Company's Share Capital amounts for 140.564 million of Japanese Yen, divided into 149.711.292 shares.

Concerning the Remuneration Policy implemented by the Company, the only information disclosed is the compensation ceiling for all the directors. Indeed, at the beginning of the paragraph, this research has already explained why individual compensation levels are still not disclosed in Japan. For the Fiscal Year 2017, the total amount paid was two-hundred and thirty-one (231) million of Japanese Yen.

Nevertheless, in 2016, the Board of Directors has proposed, for the very first time, the implementation of an equity-based long-term incentive plan, whose main features have been disclosed, in addition to the existing "Basic Compensation" and "Short-Term Performance-Linked Compensation".

In detail, the Scheme aims at further enhancing the linkage between compensation and Showa Denko share value. Indeed, the Scheme is a "Performance-Linked Stock Compensation". Beneficiaries of the Scheme are Showa Denko directors and Corporate Officers, excluding outside Directors and Auditors. Concerning the number of financial instruments to be granted under the Scheme, the Board of Directors specifies that each beneficiary receives an award proportional to his or her contribution to the firm performance. However, one million is the maximum number of financial instruments which might be issued every year under the Scheme.

Proxy advisory firms clarify how Japanese corporations, which have recently started adopting equity-based compensation plans, implement the LTIPs: a "Trust" is set up to manage the Scheme. The "Trust" bank, buys the Company's shares from the market, without causing any dilutive effect on the Company's Share Capital, that is no ownership reduction exists, or acquires the Company's treasury or newly issued shares, causing dilution instead. Until the beginning of the "Transfer Period", the shares acquired are kept in "Trust". Once the shares are transferred to the Scheme beneficiaries, the shares become disposable at each beneficiary's discretion.

Therefore, the long-term incentive plans implementation in Japan diverges from Western companies' practices.

Furthermore, for the reasons mentioned above, drawing graphs showing the trends characterizing Showa Denko's Remuneration Policy is not possible.

In conclusion, during Fiscal Year 2017, the Total Shareholder Return amounted for 251,57%, being extremely high:

$$(35{,}45 - 10{,}22 + 0{,}47) / 10{,}22$$

Data Source Yahoo Finance
Data in Japanese Yen

II.II.V Brazil, Gerdau Metalurgica S.A.

Latin America is a new challenging environment for proxy advisory firms. A theoretical framework has been deeply developed during the last decades for the United States, Britain, and Continental Europe. Conversely, in Latin America researchers have almost never investigated Corporate Governance matters. However, the tide is turning. Indeed, Brazilian companies will be required to adopt the comply-or-explain report developed by the country's Regulator, through Instruction 586 (June 2017), following the publication of the Brazilian Corporate Governance Code in late 2016. Companies have up to seven months after the end of the fiscal year to file their comply-or-explain report. The form is based on the principles of the Brazilian Corporate Governance Code, created by a group of eleven stakeholders including, among the others, the Association of Market Capital Investors (AMEC), the Brazilian Corporate Governance Institute (IBGC), and the Sao Paolo Stock Exchange.

Furthermore, Novo Mercado, a listing segment of BM&FBOVESPA, in 2017, approved an updated regulation. Among the changes implemented, there is the requirement for newly listed in the Novo Mercado segment companies to disclose the remuneration of their highest-paid administrators in accordance with the requirements of the Brazilian Securities Regulator.

As a matter of fact, improvements are strongly required for the development of an emerging market, such as Brazil, where corruption, political uncertainty, and stock volatility still are a big issue. Although many conflicts have been characterising the relationship between the United States and Latin America, the United States has a positive influence over Latin American executive compensation practices. For instance, Brazilian corporations have started disclosing the peer group of company observed to determine remuneration levels.

Considering all the specificities of the Latin American environment, the sample of companies analysed in this research includes, for the Latin American market, Gerdau Metalurgica S.A.

Gerdau Metalurgica S.A. is Brazilian company operating in the Materials segment and listed on both the BM&FBOVESPA S.A. and the MSCI Emerging Markets Latin American Small Cap Indexes. Gerdau Metalurgica S.A. is a publicly-held corporation, leader in the Latin American market for the steel supply. Recently, the Company has started expanding the mix of products offered, increasing its competitiveness, especially in Brazil. An additional feature characterizing the Company is its presence in the recycling business. Indeed, Gerdau Metalurgica transforms every year millions of tons of scrap steel into new recycled products, improving its commitment to the sustainable development of Latin America.

Among the Corporate Culture, Gerdau Metalurgica's mission is the value creation for all stakeholders: customers, investors, employees, and communities. Gerdau operates as a sustainable steel business which aims at enhancing safety, focusing on results and pursuing excellence. Moreover, the Company heavily invests in technological upgrades and follows optimal environmental practices in line with the ISO 14001 standard as defined by the Environmental Management System (EMS).

In August 2017, the Company has reported a significant change in the Corporate Governance structure. In fact, from the first of January 2018, members of the Gerdau Johannpeter family are not anymore in charge for executive offices. Both the ex-Chief Executive Officer, André Bier Gerdau Johannpeter, and the ex-vice-CEOs, Claudio Johannpeter and Guilherme Chagas Gerdau Johannpeter, are now only members of the Board of Directors, while Gustavo Werneck da Cunha is the new CEO.

According to the perspective of this research, moving from a Corporate Governance structure, which implies CEO duality, to a structure where the Management and the Board of Directors are less related, is considered as an improvement

In Fiscal Year 2017, Gerdau Metalurgica's Share Capital amounted to R$ 7.993.851.220,11, divided into 330.423.918 Ordinary Shares and 652.757.437 Preferred Shares. The data about the Share Capital are significant for the understanding of the Remuneration Policies adopted by the Company. Indeed, when analysing both remuneration packages components and the amounts executive directors earn during a fiscal year, the Share Capital is a good benchmark for the evaluation of policies' fairness.

Concerning the Company's Remuneration Policy, the Board of Directors clearly aims at attracting and retaining high-skilled executives, achieving corporate objectives, leveraging both short and long-term results through a sustainable business. Gerdau Metalurgica believes that a qualified Top Management may have a huge positive impact on the firm's performance when properly incentivized. Indeed, when remuneration policies become a "philosophy", the alignment between the Management and shareholders' interests, is enhanced, resulting in a better enterprise performance.

All the executive remuneration elements and the policies accordingly to which they are designed, are proposed and managed by the Company's Human Resources division and submitted to the Board of Directors for the Remuneration Committee's approval. All the policies are implemented focusing on benchmark companies, similar in size and operating in the Materials sector. Additionally, remuneration packages composition aims at balancing the Company's focus on the short, medium and long-term horizon.

In fact, remuneration packages include three main components: a fixed element, corresponding to the monthly salary, a short-term incentive plan, that is an annual bonus, and a long-term incentive plan.

More specifically:

i. The total fixed component earned by the Top Management is positioned in the market median. Indeed, the monthly salary provided by the Company is in line with the best market practices.
ii. The variable annual award is paid relative to the achievement of both the Company's financial results and individual performance criteria implemented for each beneficiary of the short-term incentive plan. The financial Key Performance Indicators chosen to align the managers' performance with the overall Gerdau's objectives and goals are Earnings Before Interest, Taxation, Depreciation and Amortization (EBITDA) and the Net Income.
iii. Among the benefits, the Company provides only for life insurance and health plans.
iv. Post-Employment benefits consist of a complimentary retirement plan sponsored by the Company.
v. "Plano de Incentivo de Longo Plazo, baseado em Ações Preferenciais da Companhia". The Stock Option Plan was firstly approved in the Extraordinary General Meeting held on April 30th, 2003. Then, many adjustments and amendments were implemented.

   Until Fiscal Year 2009, the only performance criterion implemented by the company was the Company's share price. In 2010, the Return on Common Equity (ROCE) was introduced as a KPI. Furthermore, during the Ordinary Shareholders' Meeting held in 2012, the exercise price computation has been changed. The new method allows for a more precise evaluation of the cost of the plan for the Company.

   When implementing the LTIP, the Plan administrator, that is the Remuneration Committees, aims at attracting and retaining talented managers, aligning the Management and shareholders' interests, strengthening the Company's culture. The ultimate objective is the value creation for all the Company's stakeholders. Hence, a vesting period of five years from the grant date and an exercise period of further five years is believed to be an optimal feature for the Plan implementation. During the last three fiscal years, no option has vested.

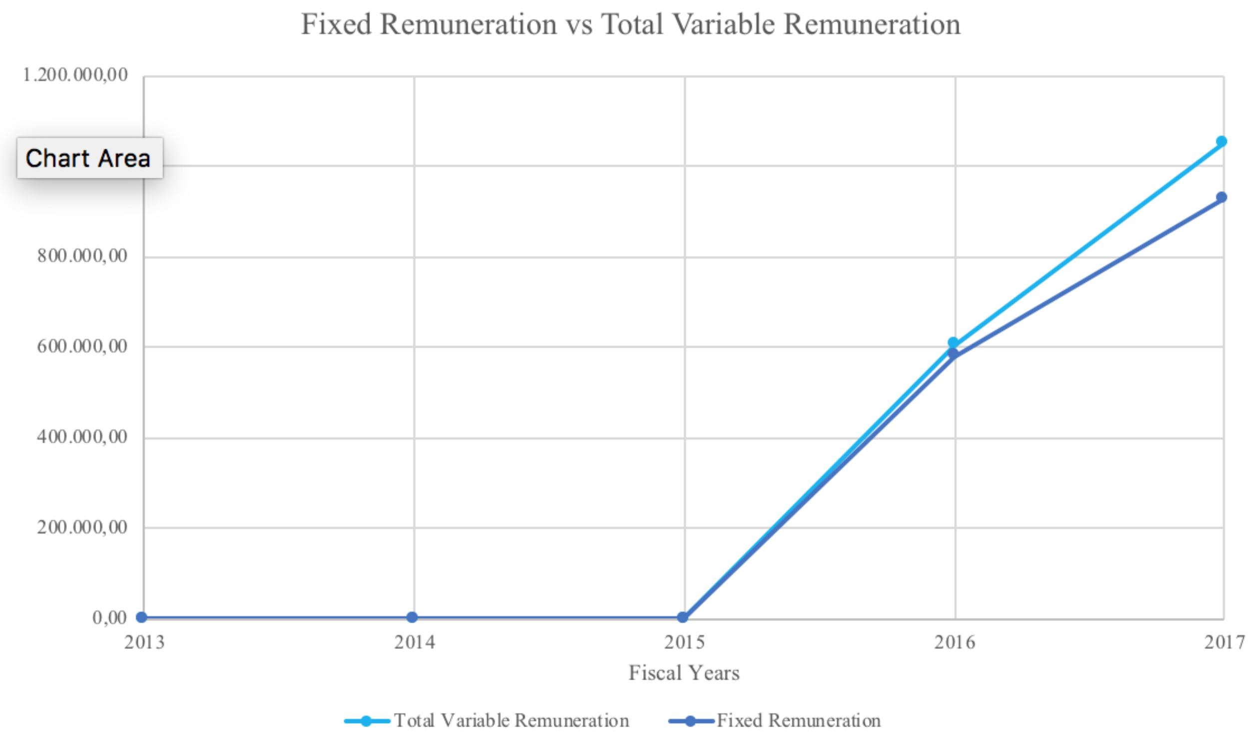
Furthermore, in case of a Change-in-Control, the options granted vests in proportion to the performance achieved by the Plan's beneficiaries.

In conclusion, the Plan does not set a specific limit for the maximum number of options which may be granted.

In the light of the above, some points might be made. Firstly, Gerdau Metalurgica shows the same issue characterizing Isagro S.p.A., that is the lack of a clear specification of the Key Performance Indicators with thresholds, target, caps and weight percentage for each criterion. Indeed, equity-based compensation plans were rarely submitted to shareholder approval prior to 2006. Only since the publication of Instruction 481 by the Brazilian Securities Regulator in 2010, companies are required to publish, at a minimum, information about the exercise price, vesting period and performance criteria.

Secondly and most important, the Company does not provide for the disclosure of the individual amounts earned by each executive director. According to proxy advisory firms' recommendations, the lack of individual disclosures is a controversial practice.

As a result, for Gerdau Metalurgica is not possible to analyse the trends in the Chief Executive Officer's remuneration, but an analysis may be conducted for the total amount of executive remuneration disclosed.

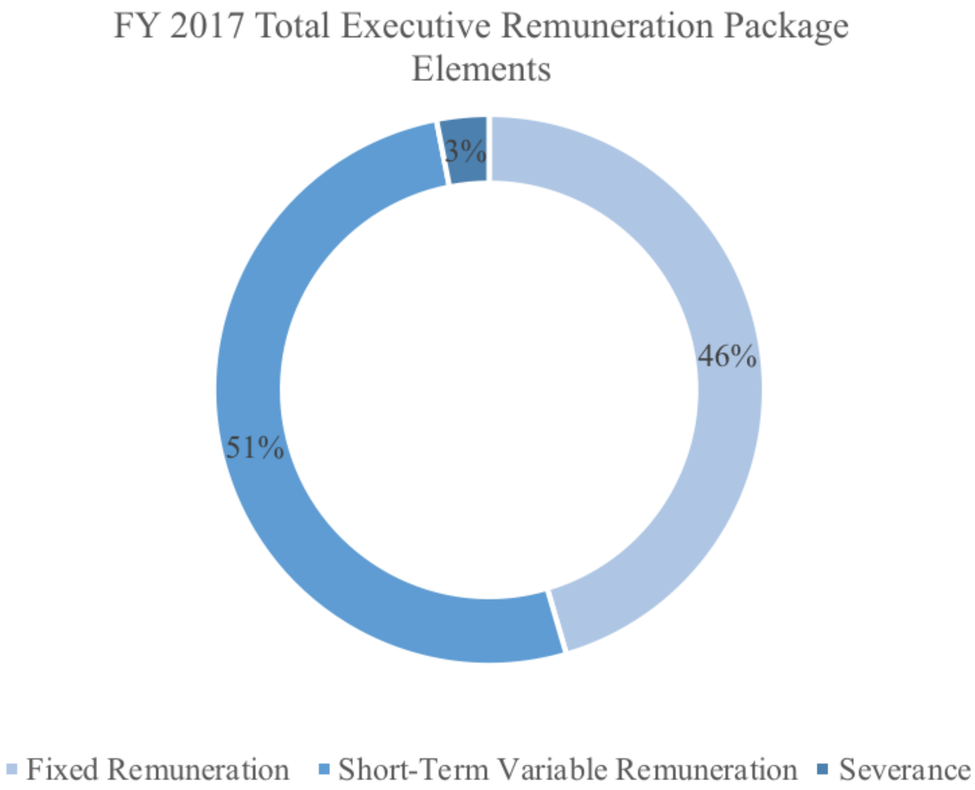


Author's analysis based on data provided by Gerdau Metalurgica S.A.

Data in Brazilian Real

**The Company has started disclosing more detailed information about executives' remuneration in Fiscal Year 2016.*

Fixed Remuneration	Short-Term Variable Remuneration	Severance
928.281,60	1.050.672,01	62.608,80



Author's analysis based on data provided by Gerdau Metalurgica S.A.

Data in Brazilian Real

The first graph displays the relevance of the Variable Remuneration in the Company's pay packages. The absence of LTIPs and equity-based incentives in the second graph is due to the fact that nothing vested during Fiscal Year 2017, although an LTIP is clearly implemented by the Company.

The incentivizing effect of the Variable Remuneration, both in the short and long-term horizon is widely recognized. Hence, to Gerdau Metalurgica should be given credit for the implementation of well-designed remuneration packages.

Nevertheless, the matter here is the lack of sufficient disclosure of information concerning the compensation earned by each executive separately.

Lastly, considering that on the November 8th, 2017, the Company has paid a dividend of 0,2 Brazilian Real, the TSR for the Fiscal Year 2017 is 23,09%.

In Brazilian Real:

(5,79 - 4,72 + 0,02) / 4,72

Data Source Yahoo Finance and BM&FBOVESPA

Data in Brazilian Real

Conclusion

This research has depicted some aspects related to the executive compensation matter.

In the first Chapter, the research has provided a detailed description of the components characterising executives' remuneration packages, emphasising the relevance of long-term incentive plans as tools which can be used by the Board of Directors to align the Management and shareholders' interests. Furthermore, in the aforementioned Chapter, this research has deeply analysed both the Agency and the Managerial Power Theory, highlighting both the differences and the similarities among the two hypotheses. Indeed, although the Managerial Power Theory asserts that the more executives are powerful within the organization the more they are often rewarded for luck, the Managerial Power Theory also asserts that improvements in Corporate Governance policies may reduce such issues, being in accordance with the Agency Theory. Where, the Agency Theory suggests that well-designed remuneration packages help mitigate agency problems arising from the separation between ownership and control in public companies.

In the second Chapter, this research analyses five companies' remuneration policies in order to show the existing differences due to dissimilarities in the economic, political and social environment where they operate. Indeed, the sample is composed of five peer companies, all similar in Market Capitalization and all running their business in the Materials sector, from five different countries. The choice of analysing small companies has been due to the emphasis which this research gives to the geographical dimension.

In the past, some researchers have already been focusing on the geographical differences in executive remuneration policies. For instance, in 2017, Edmans, Gabaix and Jenter have conducted a study which illustrates the main remuneration packages components in eleven countries from 2002 to 2009. Below the results:

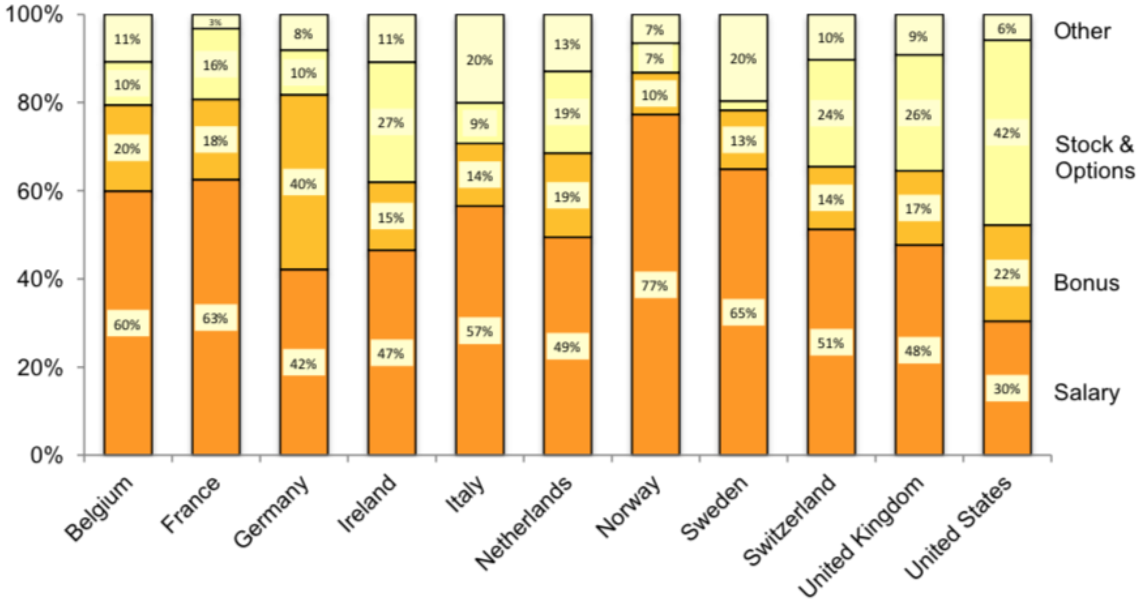


Figure 12: The Structure of CEO Compensation by Country. Edmans, Gabaix and Jenter "Executive Compensation: A Survey of Theory and Evidence" (July 17, 2017).

As the research has explained in the relative paragraphs, Italian companies are still reluctant to implement equity-based LTIPs. Conversely, in the United States, stock options, restricted stock and performance shares grants are very popular among corporations.

Specifically, among the five companies in the sample, Flotek, Lonmin, Isagro, Showa Denko and Gerdau Metalurgica, in Fiscal Year 2017, the Italian, Isagro, is the only one which has still not in place an LTIP. However, for the Fiscal Year 2018, the Board of Directors has implemented a long-term incentive plan based on both restricted stock and performance shares. On the other hand, the Japanese corporation, Showa Denko, is the only company still not disclosing detailed information about its remuneration policies.

	Base Salary	Benefits	STIPs	LTIPs	Other Compensation
Flotek Industries Inc.	✓	✓	✓	✓	✓
Lonmin Plc	✓	✓	✓	✓	✓
Isagro S.p.A.	✓	✓	✓	✗	✓
Showa Denko K.K.	✓	?	✓	✓	?
Gerdau Metalurgica S.A.	✓	✓	✓	✓	✓

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

In detail, this second table shows how the companies have implemented the LTIPs. Notice that the data for Isagro S.p.A. refers to Fiscal Year 2018 when the Plan will start granting equity.

Furthermore, the absence of stock options grants is remarkable. Indeed, after the '90s boom, corporations start understanding the real costs of granting options, which were previously wrongly ignored. The only company which still continues granting stock options is Gerdau Metalurgica, the Brazilian one. Indeed, although the Latin American context has been improving over the time thanks to the United States influence, many economic, political and social issues, which negatively affect companies' Corporate Governance system, still prevail in South America.

	Cash	Restricted Stock	Performance Shares	Stock Options
Flotek Industries Inc.	✗	✓	✓	✗
Lonmin Plc	✗	✗	✓	✗
Isagro S.p.A.	✗	✓	✓	✗
Showa Denko K.K.	✗	?	?	?
Gerdau Metalurgica S.A.	✗	✗	✗	✓

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

Concerning the benefits, common practice is providing for the company car and other perks. However, as Edmans, Gabaix and Jenter (2017) assert, because of insufficient disclosure, perks have often been labelled "stealth" compensation that may allow executives to extract rent (Jensen and Meckling, 1976; Jensen, 1986; Bebchuk and Fried, 2004). Indeed, the inclusion of perquisites in remuneration packages should always be fairly-designed and detailed-disclosed. Similarly, pension schemes, when provided, by the company should be disclosed in detail in order to avoid such form of compensation to become a way to excessively remunerate executives.

	Perquisits	Pension Scheme
Flotek Industries Inc.	✓	✗
Lonmin Plc	✓	✓
Isagro S.p.A.	✓	✗
Showa Denko K.K.	?	?
Gerdau Metalurgica S.A.	✓	✓

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

Lastly, both severance and one-off awards should be avoided, or at least implemented under special circumstances, since they may become a form of hidden compensation.

	Severance	One-off Awards
Flotek Industries Inc.	✓	✗
Lonmin Plc	✗	✗
Isagro S.p.A.	✓	✓
Showa Denko K.K.	?	?
Gerdau Metalurgica S.A.	✓	✗

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

Concluding, all the companies analysed are companies which operate in a sector, the Materials one, which requires huge investments in R&D. In fact, the five corporations in the sample are small and old but innovative organizations which adapt themselves to changes in the economic, political and social environment. They all implement fair remuneration policies which help to align the Management and shareholders' interests, and which of course, may be further enhanced, but until now have worked pretty well. Indeed, none of the companies has ever experienced bankruptcy or hostile takeovers.

Furthermore, the environment which most needs further regulations and improvements is the Brazilian one, and, conversely, the market which is developing faster is the Japanese, although there still is a lack in laws which oblige companies to disclose information.

Indeed, hoping that the research itself has further encouraged to deepen some aspects of this complex debate, the findings of this research surely open new questions for future analysis.

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Summary

Nowadays, executives' remuneration is a contentious issue. Many reasons are at the very root of the rising interest in the matter.

Firstly, since compensation contracts may affect firm behaviour, performance and value (Edmans, Gabaix and Jenter, 2017) and shareholders are concerned about the company's performance, hiring, retaining and incentivising a high-performing Management has become crucial. Indeed, this research focuses on showing the relevance of well-designed remuneration packages in enhancing the correlation between pay and performance in an Agency Theory perspective, the so-called pay-performance sensitivity. The pay-performance sensitivity indicates whether an executive is properly compensated for the actions and decisions taken when running the business.

Indeed, a first aspect emerging from the analysis of the relationship between executive's compensation and firm performance is the separation between ownership and control. Generally, shareholders delegate to the executives the task of managing firm's operational activities, with the aim of increasing the enterprise value. This might lead to agency problems, due to the conflicts of interests arising between the Management and shareholders. These conflicts of interests can be however mitigated by the intermediation of the Board of Directors which, acting on shareholders' behalf, has the power to redirect CEOs decisions through the implementation of optimal remuneration policies.

In this perspective, this research has deeply analysed both the Agency and the Managerial Power Theory, highlighting both the differences and the similarities among the two hypotheses. Indeed, although the Managerial Power Theory asserts that the more executives are powerful within the organization the more they are often rewarded for luck, the Managerial Power Theory also asserts that improvements in Corporate Governance policies may reduce such issues, being in accordance with the Agency Theory.

In brief, on one hand, the Agency Theory states that since in listed companies there is a separation between ownership and control, the Agent and the Principal may have divergent interests and may perceive the risk differently. In this context, well-designed remuneration packages mitigate these agency problems aligning the Agent and the

Principal's interests. On the other hand, the Managerial Power Theory asserts that the more power executives have against the Board of Directors, the higher their compensation is, and the weaker is the relationship between executives' pay and firms' performance. In this context, well-designed remuneration packages do not mitigate agency problems (Berle and Means, 1932). Wang, Cong and Evans (2011) assert that «Firms with stronger managerial power will be more likely to pay executives excessive compensation». In contrast, when Board of Directors is more powerful, the Management earn less and the relationship between executives' pay and firms' performance is enhanced (Maloa and Frans, 2014).

Indeed, although the effectiveness of the Agency Theory is widely recognised, some other theorists have argued that not always well-designed remuneration packages help reduce the moral hazard problem.

According to Bertrande and Mullainathan (2001), CEOs are not only rewarded for their contribution to increasing firm performance, but they are also rewarded for luck. Where luck is meant to be changed in the company performance which are beyond executives' control. For instance, exchange rate movements are not under CEOs control since they are caused by macroeconomic variables.

Concerning this research structure, a first chapter also depicts the main remuneration packages elements: base salary, benefits, short-term incentive plans and long-term incentive plans.

On one hand, the composition of remuneration packages varies based on companies' objectives. For instance, when a company aims at retaining executives in a long-run vision, pension schemes are more relevant in compensation packages. On the other hand, the composition of compensation packages varies based on the "type" of executive a company wants to attract. For instance, a compensation package with a considerable annual bonus attracts risk-prone and optimistic managers (Jensen, Murphy and Wruck, 2004).

In general, companies should aim at attracting and retaining skilled executives minimizing costs and maximizing shareholders' value. Indeed, well-designed remuneration packages should encourage managers to believe they create firm's value.

Many different definitions of compensation have been given by scholars over the years. As believed by Greckhamer (2011), compensation consists in all forms of financial returns and tangible services and perks which executives receive for having an employment agreement with a company. Scholtz and Smit (2012) define CEOs remuneration as the total cash remuneration they get, as disclosed in companies' Annual Reports (Maloa and Frans, 2014).

In detail, firstly, the base salary is one of the elements within remuneration packages. The base salary is a periodically paid amount given to executives by companies in order to recruit, reward and retain them.

On one hand, when setting the amount of base salary, companies should consider managers' competence, area of responsibility and performance. On the other hand, base salary and other elements of remuneration packages should be set looking at Corporate Governance practices of peer companies.

Secondly, "Benefits", being a broad category within remuneration packages, includes many different elements such as pension agreements, allowances specific to industries and perquisites. Where perquisites are company car, phone, and other non-cash perks.

Then, short-term incentive plans are annual bonuses subject to performance conditions. When companies design short-term incentive plans, paid in different tranches, they often defer a percentage of the bonus over twelve months in order to enhance the incentivizing effect of the award and pay the upfront percentage in cash and the deferred one in company's shares for the same reason.

Additionally, the effectiveness of short-term incentive is clear. Indeed, the immediacy and the tangibility of cash awards paid within twelve months provides a very strong incentive for executives.

Long-term incentive plans have recently evolved into a truly significant component in remuneration packages. While in the past corporations were more willing to deliver cash to their executives, nowadays remuneration schemes include many different long-term incentive plans.

On one hand, in a Human Resource perspective, long-term incentive plans are implemented in order to compete with other corporations for scarce managerial talents (Lawler, 1990; Foulkes, 1991). On the other hand, in an Agency Theory perspective, long-term incentive plans, by aligning the Management and shareholders' interests, mitigate managers' shrinking behaviour (Jensen and Meckling, 1976). Furthermore, long-term incentive plans help improve firm's performance and hence, maximize shareholders' value (Kerr and Kren, 1992).

An additional point developed by this research is the description of the different kinds of long-term incentive plans. The main distinction is between equity-based LTIPs and cash-settled LTIPs.

In fact, the most widespread form of long-term incentive plans is the option-based. Call options are contracts which give the beneficiary the right to buy one or more shares at a pre-specified exercise price – sometimes, strike price (Murphy, 1999). Other long-term incentive plans are based on financial instruments such as restricted stock and performance shares. The overtone between the two financial instruments is subtle. Performance shares are given to the plan's beneficiary only if performance criteria are met while shares are "restricted" when issued under the certain conditions, first and foremost, the plan's beneficiary having an employment agreement with the company. Lastly, long-term incentive plans may be cash settled. Corporations may issue "stock-appreciation rights" which provide the plan's beneficiary for a payment corresponding to the difference between the company's market price and the pre-settled strike price, reproducing the path of an option-based plan. Corporations may also issue "phantom shares" which give the plan's beneficiary a pay-off equal to the company's share value at a future date, replicating the pattern of a restricted stock-based plan (Jensen, Murphy and Wruck, 2004).

Eventually, "Other Compensation" includes payments which do not fit into any other category such as Board and other Committees attendance fees, severance, one-off or guaranteed bonuses, and proceeds from executives' loans.

In a second chapter, this research demonstrates through a sample of five companies how and why members of the Board a Directors differently implement remuneration packages. The companies chosen for the sample are all small listed companies obliged to disclose remuneration data in their Annual Reports. Moreover, they all operate in the Materials sector but in different countries: The United States, the United Kingdom, Italy, Brazil, and Japan. Indeed, this research aims at showing the geographical differences in executive remuneration policies among companies similar in size and running their businesses in the same field but located in countries where the economic, political and social framework differs.

Indeed, this research shows each company's Remuneration Policy trend in the last five fiscal years. In fact, a comparison between the fixed remuneration also called base salary or just salary by some of the companies in the sample, demonstrates whether a company has an updated Remuneration Policy, which focuses on the improvement of the pay-performance sensitivity.

Furthermore, this research illustrates, for the Fiscal Year 2017, which has been the Chief Executive Officer's remuneration. Indeed, through a well-designed remuneration package, companies may align CEO's interests with the ones of shareholders, achieving a better performance.

Lastly, this research uses the Total Shareholder Return (TSR) as a performance indicator. The TSR's value is computed as the difference between a company's market share price at the end of the period, usually the fiscal year, and the market share price at the beginning of the period, that is the beginning of the fiscal year (Investopedia).

Concluding, by comparing the policies implemented by the companies in the sample, this research suggests further enhancements in Corporate Governance policies, such a better implementation of LTIPs and more detailed mandatory disclosures, which should be promoted by both the companies analysed and the regulator.

In detail, the five companies analysed are Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., and Gerdau Metalurgica S.A., listed on the S&P 600 Small Cap, FTSE 350 Small Cap, STAR, MSCI AC Asia Pacific Small Cap and MSCI Emerging Markets Latin American Small Cap Indexes.

Firstly, Flotek Industries Inc. is an American corporation listed in the S&P 600 Small Cap Index.

Nowadays, Flotek is a leading company developing and supplying chemistry products and services, to the Oil and Gas industries, and chemistry compounds to companies producing cleaning products, cosmetics, food, and beverages. Indeed, Flotek operates through two segments: Energy Chemistry Technologies (ECT), and Consumer and Industrial Chemistry Technologies (CICT).

The Company has well-designed remuneration packages for the Top Management, which include:

vi. Base Salary, reviewed annually accordingly to the selected Peer Group's practices.

vii. Annual Bonus. Participants to the short-term incentive plan receive an annual cash incentive based on Flotek performance. The performance criteria have been expanded from a single financial measure to two financial measures and an individual KPI established for each beneficiary. Allocation of the total target payment is as follow: 60% based on the Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA) target, the so-called "EBITDA Bonus"; 20% based on the Revenue target and 20% based on performance against individual goals, the "Goal Bonus".

    If the EBITDA Bonus threshold level, \$27.5 million, is achieved, 50% of the award is paid. If the EBITDA Bonus target level, \$32.0 million is achieved, 100% of the award is paid. If the EBITDA Bonus cap level, \$38.0 million is achieved, 200% of the award is paid.

    If the Revenue Bonus threshold level, \$300.0 million, is achieved, 50% of the award is paid. If the Revenue Bonus target level, \$335.0 million is achieved, 100% of the award is paid. If the Revenue Bonus cap level, \$370.0 million is achieved, 200% of the award is paid.

viii. Stock Awards, that is an LTIP.

ix. All Other Compensation, including Vehicle Allowance, Company Provided Housing and Services and Consulting Contracts.

x. Severance.

What is evident is the relevance of variable remuneration in American pay packages. Indeed, researchers believe that the increase in American executive remuneration is due to the implementation of long-term incentive plans.

However, Flotek Industries is an exception to the trend. Indeed, the Company has implemented a LTIP based on restricted stock and performance shares without issuing option awards.

Secondly, Lonmin Plc. is the company, listed in the FTSE 350 Small Cap Index, analysed. Lonmin is a leading producer of Platinum Group Metals, hence operating in the Materials sector. Those metals are needed for many industrial applications.

In the United Kingdom, the quality of Corporate Governance has continued to improve over the time and for instance, nowadays, the "comply or explain" approach has allowed British corporations to respond effectively to the evolving environment trends.

More specifically, Lonmin's remuneration pay packages are structured as follow:

vi. Base Salary. Offering market-competitive levels of fixed compensation helps the Company to attract and retain skilled managers. Indeed, the salary is paid in cash monthly. The level reflects both the employee's skills and experience and is set based on peer companies' practices.

vii. Benefits. Lonmin offers a wide range of perquisites including the Company's vehicle, private medical insurance, income protection insurance, life insurance, professional advice, security

viii. Retirement benefits. Contributions to pension schemes which may not exceed the 20.52% of the Base Salary.

ix. Annual Bonus. The two short-term incentives aim a creating a strong performance culture. They are the "Balanced Scorecard Plan" – BSC - and the "Annual Share Award Plan" - ASAP. Respectively, the first award is paid in cash while the second one in shares. Malus and claw-back provision are provided by the Company. Moreover, for the BSC, the KPIs are set at the corporate level with a weight of 80% (Safety, Transformation, Production and Financial) and are linked to personal objectives for the remaining 20%.

x. LTIP. The long-term incentive plan aims at aligning the Management and shareholders' interests by linking the reward, paid in the Company's shares, to the long-run performance. The award vests in three tranches after three years after the grant date, meaning that the Plan lasts five years. Furthermore, the vesting of the award is based on financial, operational and share price-based measures set by the Remuneration Committee. The KPIs are aligned with the long-run strategy implemented by the Company.

Established in 1993 and listed on the STAR segment since 2003, Isagro invests in new molecules and in the improvement of active substances without having a huge impact on the environment. Indeed, Isagro is an innovative company investing in research and development.

Concerning executives' remuneration, remuneration packages are set accordingly to best practices adopted by peer companies – small and middle listed companies operating in the Chemicals subsector - and they include:

vi. A fixed annual component.

vii. A variable annual component, linked to the achievement of performance objectives. Such objectives are measurable and designed to create shareholders' value. The Board of Directors sets in advance strategic and financial criteria which are in line with the Annual Budget. Each goal has a specific weight in determining the performance achievement and a threshold, a target, and a cap level are set by the Company.

In addition, the variable annual component amounts for a percentage between the 10% and the 35% of the fixed remuneration. There is no deferral period and no malus or claw-back clauses are included in the design of the annual bonuses.

viii. Fringe benefits such as the Company's car and an insurance policy, the so-called "Directors&Officers".

ix. One-off bonuses may be granted under special circumstances.

x. "Restricted Shares and Performance Shares Plan 2018-2021". For the very first time, Isagro, in line with Corporate Governance best practices and with market standards, opted for the implementation of a long-term incentive plan.

The Plan aims at retaining skilled employees, involved in the Company's "Industrial Plan" implementation, at achieving long-run objectives, and at enhancing the Top Management team work. Indeed, the Board of Directors, which is the Plan administrator together with the Nomination and Remuneration Committees, firmly believes in the relevance of the Plan for the alignment of Management and shareholders' interests.

The Plan lasts four years, form the first of January 2018 until the thirty-first of December 2021. Beneficiaries of the Plan are nine executive directors whose actions and decisions impact the Company's performance. The financial instruments assigned are the Company's Growth Shares whose issuance determinates a dilutive effect on the Company's Share Capital. Moreover, the Growth Shares issuance is subject to both the existence of an employment agreement between the Company and the Beneficiary until the end of the Plan and the achievement of some performance criteria. Indeed, the financial instruments granted are both Restricted Shares, amounting to the 50% of the total award, and Performance Shares, amounting to the remaining 50% of the total award.

Additionally, the maximum number of financial instruments which may be granted amounts for one million and the financial instruments' value is set as the average closing price of the Company's shares during ninety days before the issuance date.

The longer is the vesting period, the better shareholders may gather information about the firm's performance during the implementation of the plan. Here, the maximum vesting period, four years, differs from the minimum vesting period, only two years. Indeed, the Restricted Shares start vesting at the 2019-year-end, and they are assigned to the Plan's beneficiaries in three tranches until the end of the plan. On the other hand, the Performance Shares vests over a period of four years and are granted in cliff during the Fiscal Year 2022.

Concerning the performance objectives to be achieved by the Plan's beneficiaries, they are financial KPIs with a weight of 25% each. They are Isagro's Ordinary Share Value, EBITDA / Revenues ratio, Net Working Capital / Revenues ratio and Net Financial Position / EBITDA ratio.

Some clauses are provided by the Plan administrator in case of employment termination. In a bad leaver hypothesis, that is misconduct of one of the beneficiary, the Plan's beneficiary loses the right to receive the award. Moreover, in the hypothesis of Change-in-Control, that is a hostile takeover such as a merger or acquisition, the Board of Directors may accelerate the award vesting even without being authorized by the shareholders. In the latter case, the Plan's beneficiaries receive the award even without having achieved the performance conditions set when the Plan has been implemented. The only condition to receive the award the Plan's beneficiaries are subject to in case of a Change-in-Control is the continuation of their employment with the Company which has taken over Isagro S.p.A.

In conclusion, although Isagro's Remuneration Policy should be further improved in order to be even more in line with Corporate Governance best practices and proxy advisory firms' recommendations, it is implemented accordingly to market standards. Concerning the "Restricted Shares and Performance Shares 2018-2021", some features such as KPIs specification should be enhanced in order to have pay and performance further aligned.

What is clearly evident is the lack of changes in Isagro's Remuneration Policy during the last five fiscal years. Furthermore, the Total Variable Component, compared to the Base Salary, does not amount even for the half of the CEO's remuneration package.

However, although a lack of changes is typical in Italian companies since an equity-based incentive plan has been implemented this fiscal year, Isagro S.p.A is an evidence of the wave of improvements in Corporate Governance policies in Continental Europe markets.

Concerning the Japanese framework, corporations have started disclosing some information about executive compensation later in 2009. Indeed, the Japan Cabinet Office Ordinance on Disclosure of Corporate Affairs was revised only in 2010 when the disclosure of individual remuneration data has become mandatory for listed companies with executives earning more than a hundred million Japanese Yen (Sakawa, Moriyama and Watanabel, 2012). In companies where managers receive less than a hundred million Japanese Yen, the information concerning executive pay is disclosed only as an aggregate amount of total remuneration (Ganu, 2014).

In conclusion, nowadays the background is improving. Since both investors and regulators are asking for more detailed disclosures on pay levels, remuneration packages design and Top Management performance assessments, the focus on executives' remuneration policies is increasing. Proxy advisory firms suggest Asian companies a split in remuneration reports where a first section should introduce future changes in remuneration practices and a second section should explain the implementation of the policy for the reported fiscal year. Then, an additional suggestion is enhancing the focus on equity-based remuneration. As a result, Asian companies will start following the pattern of Western companies where information disclosures are undoubtedly more encouraged.

In a constantly improving emerging market, Showa Denko K.K. is the Japanese company included in this research' s sample. It is listed in the MSCI AC Asia Pacific Small Cap Index.

Showa Denko K.K., established in 1939 by the merger of Nihon Denki Kogyo K.K. and Showa Hiryo K.K, is a Japanese leading company in the Materials sector, operating in six major segments: petrochemicals, chemicals, electronics, inorganics, aluminium, and others – building materials.

Concerning the Remuneration Policy implemented by the Company, the only information disclosed is the compensation ceiling for all the directors. Indeed, this research has already explained why individual compensation levels are still not disclosed in Japan. For the Fiscal Year 2017, the total amount paid was two-hundred and thirty-one (231) million of Japanese Yen.

Nevertheless, in 2016, the Board of Directors has proposed, for the very first time, the implementation of an equity-based long-term incentive plan, whose main features have been disclosed, in addition to the existing "Basic Compensation" and "Short-Term Performance-Linked Compensation".

Eventually, Latin America is a new challenging environment for proxy advisory firms. A theoretical framework has been deeply developed during the last decades for the United States, Britain, and Continental Europe. Conversely, in Latin America researchers have almost never investigated Corporate Governance matters. However, the tide is turning. Indeed, Brazilian companies will be required to adopt the comply-or-explain report developed by the country's Regulator, through Instruction 586 (June 2017), following the publication of the Brazilian Corporate Governance Code in late 2016.

In such context, Gerdau Metalurgica S.A. is Brazilian company operating in the Materials segment and listed on both the BM&FBOVESPA S.A. and the MSCI Emerging Markets Latin American Small Cap Indexes. Gerdau Metalurgica S.A. is a publicly-held corporation, leader in the Latin American market for the steel supply. Recently, the Company has started expanding the mix of products offered, increasing its competitiveness, especially in Brazil.

Gerdau's remuneration packages include three main components: a fixed element, corresponding to the monthly salary, a short-term incentive plan, that is an annual bonus, and a long-term incentive plan.

More specifically:

vi. The total fixed component earned by the Top Management is positioned in the market median. Indeed, the monthly salary provided by the Company is in line with the best market practices.

vii. The variable annual award is paid relative to the achievement of both the Company's financial results and individual performance criteria implemented for each beneficiary of the short-term incentive plan. The financial Key Performance Indicators chosen to align the managers' performance with the overall Gerdau's objectives and goals are Earnings Before Interest, Taxation, Depreciation and Amortization (EBITDA) and the Net Income.

viii. Among the benefits, the Company provides only for life insurance and health plans.

ix. Post-Employment benefits consist of a complimentary retirement plan sponsored by the Company.

x. "Plano de Incentivo de Longo Plazo, baseado em Ações Preferenciais da Companhia". The Stock Option Plan was firstly approved in the Extraordinary General Meeting held on April 30th, 2003. Then, many adjustments and amendments were implemented.

Until Fiscal Year 2009, the only performance criterion implemented by the company was the Company's share price. In 2010, the Return on Common Equity (ROCE) was introduced as a KPI. Furthermore, during the Ordinary Shareholders' Meeting held in 2012, the exercise price computation has been changed. The new method allows for a more precise evaluation of the cost of the plan for the Company.

When implementing the LTIP, the Plan administrator, that is the Remuneration Committees, aims at attracting and retaining talented managers, aligning the Management and shareholders' interests, strengthening the Company's culture. The ultimate objective is the value creation for all the Company's stakeholders. Hence, a vesting period of five years from the grant date and an exercise period of further five years is believed to be an optimal feature for the Plan implementation. During the last three fiscal years, no option has vested.

Furthermore, in case of a Change-in-Control, the options granted vests in proportion to the performance achieved by the Plan's beneficiaries.

Lastly, the Plan does not set a specific limit for the maximum number of options which may be granted.

In the light of the above, some points might be made. Firstly, Gerdau Metalurgica shows the same issue characterizing Isagro S.p.A., that is the lack of a clear specification of the Key Performance Indicators with thresholds, target, caps and weight percentage for each criterion. Indeed, equity-based compensation plans were rarely submitted to shareholder approval prior to 2006. Only since the publication of Instruction 481 by the Brazilian Securities Regulator in 2010, companies are required to publish, at a minimum, information about the exercise price, vesting period and performance criteria.

Secondly and most important, the Company does not provide for the disclosure of the individual amounts earned by each executive director. According to proxy advisory firms' recommendations, the lack of individual disclosures is a controversial practice.

However, the incentivizing effect of the Variable Remuneration, both in the short and long-term horizon is widely recognized. Hence, to Gerdau Metalurgica should be given credit for the implementation of well-designed remuneration packages.

Summing up, the three tables below depicts the main features of the remuneration packages implemented by each of the companies in the sample:

	Cash	Restricted Stock	Performance Shares	Stock Options
Flotek Industries Inc.	✗	✓	✓	✗
Lonmin Plc	✗	✗	✓	✗
Isagro S.p.A.	✗	✓	✓	✗
Showa Denko K.K.	✗	?	?	?
Gerdau Metalurgica S.A.	✗	✗	✗	✓

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

	Perquisits	Pension Scheme
Flotek Industries Inc.	✓	✗
Lonmin Plc	✓	✓
Isagro S.p.A.	✓	✗
Showa Denko K.K.	?	?
Gerdau Metalurgica S.A.	✓	✓

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

	Severance	One-off Awards
Flotek Industries Inc.	✓	✗
Lonmin Plc	✗	✗
Isagro S.p.A.	✓	✓
Showa Denko K.K.	?	?
Gerdau Metalurgica S.A.	✓	✗

Author's analysis based on data provided by Flotek Industries Inc., Lonmin Plc., Isagro S.p.A., Showa Denko K.K., Gerdau Metalurgica S.A.

All the companies implement fair remuneration policies which help to align the Management and shareholders' interests, and which of course, may be further enhanced, but until now have worked pretty well. Indeed, none of the companies has ever experienced bankruptcy or hostile takeovers.

Furthermore, the environment which most needs further regulations and improvements is the Brazilian one, and, conversely, the market which is developing faster is the Japanese, although there still is a lack in laws which oblige companies to disclose information.

Indeed, hoping that the research itself has further encouraged to deepen some aspects of this complex debate, the findings of this research surely open new questions for future analysis.