

Remuneration and Shareholder Value Performance Bonuses for a growth company.

Discussion paper

The performance bonuses for the employees of the Company fall into three categories as follows:

1. Directors
2. Head Office staff
3. Business unit management

The underlying principle is that all staff should have a market rate package (reviewed annually to market) plus a performance bonus. The bonus component will encourage them to improve the value of the business to the shareholders both short term and long term, while striving for best business unit and maintaining the highest ethical and clinical standards.

The directors must ensure that the business grows and produces positive shareholder value. They also must discharge their full responsibilities as directors for the good governance of the business and ensure that the business meets its strategic objectives.

The directors' remuneration will be- market rate directors' fees and a bonus scheme which will reward the directors for profitable growth as follows:

If the business has grown in size, measured by economic profit above the cost of capital, then the directors will receive an issue of share equal to 1% each of the issued shares at 30th June each year, if the growth is 100% since the previous 30th June. Otherwise the % issued will reflect the proportion achieved, so for example, if the growth is 50% then the issue is ½% to each director. Any director leaving during the year will have their entitlement prorated on a time basis, based on the financial information at the nearest quarter's accounts.

Example:

\$000s	Years 30th June 2006	30th June 2007	30th June 2008	30th June 2009
Revenue	5,000	6,000	7,000	8,000
Costs	4,000	4,500	5,000	5,500
EBIT	1,000	1,500	2,000	2,500
Tax Calculated at 30%	300	450	600	750
Economic Profit	700	1,050	1,400	1,750
Capital employed	6,000	9,000	11,000	14,000
Cost of capital at WACC rate 10%	600	900	1,100	1,400
Residual economic value REP	100	150	300	350
Performance		50.00%	100.00%	16.67%
Shares issued		0.50%	1.00%	0.17%

The above table shows the revenue less costs producing the earnings before interest and tax (EBIT). From EBIT is deducted tax calculated at the marginal tax rate for the company (30%), which produces the economic profit. From the economic profit is deducted a charge for the capital at the weighted average cost of capital, which produces the residual economic profit (REP) above the cost of capital. This residual economic profit is the basis for shareholder value as the value created above the cost of capital increases the value of the business and is the basis of the bonus schemes.

The shareholder reward the directors for increasing the value added through growth (with profitable acquisitions and profitable organic growth stimulated by good marketing) and good operational management of the business units to improve the EBIT through best business unit management. The cost of capital will also be impacted by the directors by ensuring that the business units are purchased at the right price- thereby reducing the amount of capital required and through best business unit management of the balance sheet to minimise the capital employed.

Head Office staff

Head office staff to be paid market rate salary packages plus a bonus taken from a bonus pool based on the increase in the residual economic profit from one year to the next. This is similar to the director share issue, but at a lower level and offered as cash with the option to take up the bonus as shares. There will also be the option to forego salary package in favour of shares which will be negotiated on a one-on-one basis.

Example:

HQ Staff \$000s	Years 30th June 2006	30th June 2007	30th June 2008	30th June 2009
Revenue	5,000	6,000	7,000	8,000
Costs	4,000	4,500	5,000	5,500
EBIT	1,000	1,500	2,000	2,500
Tax Calculated at 30%	300	450	600	750
Economic Profit	700	1,050	1,400	1,750
Capital employed	6,000	9,000	11,000	14,000
Cost of capital at WACC rate 10%	600	900	1,100	1,400
Residual economic value	100	150	300	350
Increase in REP		50	150	50
Bonus pool 1%		0.5	1.5	0.5

Payment method and locking in of staff

The actual payments of the bonus will be over 3 years, with 1/3rd paid per year. The rules will be very strict, if a staff member leaves they forfeit any outstanding bonuses not yet paid i.e. the bonus is contingent on continuing with the business. The following shows the bonus pool for the example above:

Total	2008	2009	2010	2011	2012
0.5	0.17	0.17	0.17		
1.5		0.5	0.50	0.50	
0.5			0.17	0.17	0.17
2.5	0.17	0.67	0.83	0.67	0.17

Business unit Management

The basic principle of the business unit management bonuses is to encourage the business units to adopt best practice under the guidance of Company through Head office guidance such that the performance of the business unit increases its contribution to shareholder value creation and encourage growth in revenue.

The business unit bonus pool is to be set at 17.5% of additional REP over the previous year and 2.5% of total REP. This puts the emphasis on the growth. Any negative growth will attract a negative bonus or claw back, which may occur if significant changes temporarily increase costs with benefits in additional profit flowing in the following periods. This will encourage well thought through changes to organisational structure or operational configuration so that such investment is more likely to produce positive returns. This will encourage “ownership behaviour” at the business unit level as it will directly impact the REP bonus pool particularly the growth component as the following example shows:

Business unit Bonus		Years					
		30th	30th	30th	30th	30th	30th
		June	June	June	June	June	June
\$M		2006	2007	2008	2009	2010	2011
Revenue		900	1,000	1,200	1,600	1,700	1,750
Costs		620	640	950	960	970	980
EBIT		280	360	250	640	730	770
Tax Calculated at	30%	84	108	75	192	219	231
Economic Profit		196	252	175	448	511	539
Capital employed		1,000	1,300	1,400	1,430	1,460	1,490
Cost of capital at WACC rate	10%	100	130	140	143	146	149
Residual economic value		96	122	35	305	365	390
Increase in REP bonus on increase	17.5%		26	-87	270	60	25
Bonus on total	2.5%	2.4	3.1	0.9	7.6	9.1	9.8
Bonus pool	20.0%	2.4	7.6	-14.4	54.9	19.6	14.1

Payment method and locking in of business unit staff

The actual payments of the bonus will be over 3 years, with 1/3rd paid per year. The rules will be very strict, if a staff member leaves they forfeit any outstanding bonuses not yet paid i.e. the bonus is contingent on continuing with the business. The following shows the bonus pool for the example above. Note that in year 2008 when the pool becomes negative that no repayment is made, but it is taken from the following year's bonus reducing it from 16.04 to 14.59. This would continue until the cumulative balance is positive. This would encourage the business unit management to deliver the benefits quickly from the investment in cost structure in year 2008.

There will also be the option to forego salary package in favour of shares which will be negotiated on a one-on-one basis.

Total	2006	2007	2008	2009	2010	2011
1.60	0.80	0.80	0.80			
7.60		2.53	2.53	2.53		
-14.35			-4.78	-4.78	-4.78	
54.88				18.29	18.29	18.29
13.08					6.54	6.54
4.71						4.71
67.52	0.80	3.33	-1.45	16.04	20.05	29.54
				-1.45		
				14.59		

Conclusion on remuneration and bonuses

These methods of paying market packages and performance bonuses will attract and retain the right calibre of staff and business unit management and encourage them at all levels of the business:

- to grow shareholder value,
- Preserve cash as they are paid out over three years (or can opt for their bonus in shares) and encourages staff loyalty.
- And keeps the focus on both short term and a longer term business performance by all involved in the business.