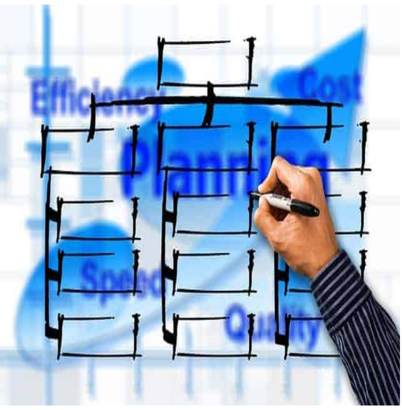


# Why Management Pay Matters to Investors Just Like You

## Description

The issue of management pay has become more popular in recent years. However, the focus has not normally been on how CEOs and CFOs are paid, but rather how much they are paid. In some cases and in some regions it is many multiples of an average salary, which is generally viewed as being unfair by many individuals.



The amount, though, should not matter all that much to investors. The reality is that most investors are happy for the management team of their successful business to be handsomely rewarded. The real focus, therefore, should be on ensuring that the right incentives are in place to encourage sustainable growth and share price rises over a long period of time.

## Cash

Practically all senior managers receive total pay which includes a bonus for reaching specific targets. This incentive is crucial in order for them to invest their capital in the areas which are most beneficial to the long-term performance of the business. In some cases, this can simply be a cash bonus for meeting certain goals. While this may increase motivation, it may also lead to short-termism and a failure to act in the best interests of the long-term future of the business.

## Shares

A better alternative to cash bonuses is where management incentives take the form of shares in the company. This is a sound idea, since it means that they could develop a substantial holding in the company and their financial interests may eventually be closely aligned with those of the company's shareholders. This should mean that they pursue the growth opportunities which could have the biggest impact on the company's share price. As a result, they will work towards a higher share price and, ultimately, higher capital growth for the company's investors.

## Stock Options

However, simply issuing shares to company management does not guarantee they will act in the best long-term interests of the business. Some managers who have a substantial shareholding may seek to generate high short-term capital growth on their shares. This may lead to them prioritising short-term decisions over long-term ones, with a focus on acquisitions, increasing earnings through measures such as share buybacks and increasing debt levels in order to expand more rapidly.

A better idea than issuing shares could be stock options. This is where an employee has the right to purchase shares in the company at a predetermined price. Stock options take a specified number of years to vest (vesting refers to an employee gaining ownership over the stock options), and this encourages them to make decisions that will bear fruit over the long run, rather than the short run. In this sense, their interests will be very closely aligned with those of long-term investors.

## Takeaway

Finding out how senior management is incentivised is relatively straightforward. Details of director pay are included in a company's annual report. Ensuring that the interests of the CEO and CFO in particular are closely aligned with those of shareholders could help to ensure that the company delivers high and sustainable returns over an extended period of time.



**CATEGORY**

1. Investing

**PARTNER-FEEDS**

1. Msn
2. Yahoo CA

**Category**

1. Investing

**Date**
2025/08/26
**Date Created**
2017/09/24
**Author**
peterstephens