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TRANSCRIPT

In the Gold Mines of CEO Pay

Featuring:

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Bentley Kaplan:

Hello, and welcome to the weekly edition of ESG Now, where cover how the environment, our society and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, your host for this episode. And while my co-host Mike Disabato has gone global and is currently getting his full of British culture, I'm going to go the other way by giving the show a little more of a local flavor, or at least, local for me. Because on today's show, we are going to take a look at the pay package of Neal Froneman, the CEO of Sibanye-Stillwater, a mining company listed on the Johannesburg Stock Exchange.

Sibanye-Stillwater operates mostly within South Africa, but also has interest in places like the U.S. and Zimbabwe. And for the 2021 financial year, the CEO Neil Froneman earned a pay package of around R300 million, which is around $19 million. Now the question of executive pay on its own is interesting enough to be sure. It's a topic that is gaining more attention from investors and something that was thrust very much into the spotlight during the COVID-19 pandemic. But today, we are playing a little bit of ESG bingo. And in addition to executive pay, we're going to throw in striking unions, economic inequality, and clean energy metals. And like any good ESG story, it's difficult to figure out where one topic ends and another one begins. And without further ado, thank you for sticking around. Let's do this.

So let's start with a figure that has kicked off a polarizing debate in some sections of South African media, R300 million, which equates to around $19 million. Now in fairness to the U.S., where things tend to be a lot bigger and a lot better, a $19 million pay package doesn't raise too many eyebrows. Maybe that's because of a case of eyebrow fatigue, but I don't want to speculate. In a South African company context, $19 million is pretty meaningful. Annual reports are still being published to cover the 2021 year, but for now, Froneman stands comfortably ahead of local CEOs where generous pay packages tend to fall somewhere between R50 million and R100 million in a good year.

And like most other CEOs who are having a good year, Froneman's pay package is a combination of a cash salary, in this case, roughly R28 million and a much bigger chunk of performance incentives in the form of share holdings. Opinions of Froneman's pay package have ranged from outrage at its alleged exorbitant to those seeing it as a fair reward for smart business decisions in the face of uncertainty. And all the way to those suggesting that the nature of executive pay is too complex a topic to be shared and therefore debated outside the boardroom. To give us a much needed context, I bugged one of MSCI's corporate governance gurus Zanele Mtshali, coming to us out of our London office. And the first thing Zanele did was to walk me through this specific pay package and how the company might have taken the decisions that led them to this point.

Zanele Mtshali:

Pay packages in most developed markets are designed in very similar ways in that there's a fixed component, which is usually your salary and your pension, and a few other perks and that gets paid out no matter what. And then you have performance-related pay, which is made up of an annual bonus component, and then a long-term incentive component. The annual bonus obviously measured over a year, the long-term component usually measured over around three years with possibly a holding period. And then that sort of three year periods, you have metrics that are used to measure the performance, and it's usually financial performance. Usually some sort of measure of return to shareholders and then another sort of financial component ROIC or return on invested capital.

These policies are put together by the board level pay committee, but the people who do sort of the heavy lifting on putting these policies together, you'll find a pay consultants or remuneration consultants who get paid to design these packages. And the idea being that you've got an independent external body that's creating something that's supposed to be fair, what is fair? What is fair in the UK? What is fair in the U.S? What is fair in South Africa? In this particular case with Mr. Froneman's pay in a country like South Africa, where you do have large amounts of income inequality is R300 million as an outcome fair?

Bentley Kaplan:

Right. So I don't want to give away too much too soon, but this isn't going to be the kind of story where things are straightforward or one where we can easily tell you which side to pick. This is a story with nuance. As Zanele points out, CEO pay isn't happening in a vacuum, there's market industry context at play. And even though you'd have a hard time showing a direct connection between Sibanye-Stillwater's operations and South Africa's growing inequality, for many, the question of fairness is about trying to reconcile the gap between a CEO's pay package and the average worker.

And however you feel about that, and however subjective that argument could be, in Froneman's pay package, we have something objective and quantified, which is what I ask Zanele about next. Because in the company's public disclosures, you can go and see how calculations were made and which building blocks ultimately stack up to the R300 million. And Froneman and many other CEOs as well, the lion share of this pay package comes from the besting of share awards or long-term incentive plans, LTIPs, if you're jonesing for an acronym. And a big chunk of those awards are linked to specific financial outcomes. If a company does well, the awards get generous, which in the face of it makes sense. The type of CEO commission system, one with potential upsides clearly, but also one with potential downsides if a company does poorly. And on the face of it, this type of performance-based award makes a lot of sense, right?

Zanele Mtshali:

The whole point of putting in this performance piece in the first place back following the financial crash of well, 2007, 2008, was that they wanted to have something that reflected individual, that the individual's ability to impact their pay, right? So that you weren't seeing bonuses payout regardless of the share price tanking. It's clearly not worked no matter where you look, whether that's because of the macroeconomic situation, you can also look at that or share buybacks, that sort of thing. We've been in a bull market for these 10 years now, so as to the CEO's individual performance, if you're in a bull market, your share price is going to stay up, right?

Bentley Kaplan:

Right. And this is the difficulty of a complex system like a company. There are countless internal and external factors that interact with each other to ultimately land on specific financial outcome like total shareholder return or return on capital employed. It's very difficult to pull out one or two variables, especially something like the CEO's decision making and directly link them to our performance or under performance. So when pay packages start to bulge, a lot of scrutiny falls on whether the metrics that were suggested by a pay consultant and adopted by a board's pay committee makes sense? Whether they are reasonable and objective?

And yes, Froneman had a good year in 2021, but if we zoom out a little bit further, we can see just what a step up that was from preceding years. In 2020, he took home R62.7 million. And in 2019, a much more modest R34.5 million. But again, this is not a company operating in a vacuum. I'll be the first to profess my ignorance of the gritty details of the mining industry. But at this distance, it looks difficult and highly pressured. And if you are one of Sibanye-Stillwater's investors, you might see in Mr. Froneman the type of CEO that is going to help the company's long term prospects. And if that's the case, then the pay package isn't only about making sure that it's fair or linked to company performance, but also one that won't have him looking around for greener pastures.

Zanele Mtshali:

The competition angle of it and retention angle of it is always a tricky one. Shareholders, I think generally don't want to see people get fired if they're doing well, which he clearly is. In this case, if they don't want to put him in a position where he feels that he should leave, because his salary is getting cut, it's a tricky one. And I mean, you can see the pay committee in this particular case as well has intervened, right? They have made some changes following last year's AGM. So they're brought in a few tweaks to the policy, including things like Madison callback.

And one of the other things they brought in was an 20% ESG component, which they applied to the 2021 annual bonus that he got. They cut 20% off one of the LTP payments that they paid him because of increased deaths, right? So the deaths increased from 9 to 20 from 2020 to 2021. So by having an ESG component that's linked to things like health and safety and other things that ESG performance they figured will they cut that much off his payout just to reflect the seriousness of the situation and hopefully try and figure out some ways of presumably reducing it for the following year. But he's still walking out with R300 million.

Bentley Kaplan:

Okay. So this is not the first time that executive pay at Sibanye-Stillwater has been in the hot seat. Shareholder votes in particular at the company's 2019 and 2021 AGMs, both pointed to dissatisfaction with either the company's performance or specific details in the company's remuneration policy. And the pay committee has made some changes after these votes. One of the more interesting ones that Zanele talks about is linking some of the CEO's bonus and long term incentive plans to specific ESG metrics, in this case, work of fatalities.

By doing so, the company can either incentivize top down efforts to improve employee safety in order to preserve that sweet chunk of pay, or if there's not the required improvement to see some of that paid docked, a kind of penalty. And this step might be a good one especially for a company that has had some history of safety issues. Sibanye-Stillwater recorded 24 employee deaths in 2018, 11 in 2017 and 14 in 2016. And we can put this safety risk into context. As of September, 2021, Sibanye-Stillwater scored a 3.2 out of 10 on our health and safety key issue, which is below the average for its metals and mining peers that specialize in precious metals. And this low score was driven in part by gaps in the company's safety management practices and relatively high injury and fatality rates.

And as Zanele highlights, in 2021 the company missed the ESG target that was included in its remuneration policy. And so 11 more workers lose their lives compared with 2020. But even having missed that target, the CEO is still bagging a sizeable pay package for 2021. So maybe not surprisingly, governance analysts like Zanele and investors alike will be keeping an eye on Sibanye-Stillwater upcoming AGM. And just a heads up, Zanele is going to mention the king code, which refers to the king code of governance principles, a set of principles and recommended practices that guides corporate governance norms in South Africa, including full listed companies.

Zanele Mtshali:

The AGM for Sibanye is coming up next week so that'll be an interesting one to see what the outcome is, how shareholders feel about it. And there's two potential scenarios. The one would be that shareholders oppose the pay report by 25% or more, which would be the point at which the company would have to engage with shareholders and then disclose that engagement in its next annual report. And that would be because of the king code recommendation. And then the other scenario is that you get around 25% or less opposition, at which point you get what's called a shareholder rebellion where there's obviously enough discontent that people are unhappy. But it doesn't trigger any sort of engagement responsibility from the company, but that would be the sort of thing that makes the news and keeps this story going for another few weeks until the next issue comes up.

Bentley Kaplan:

As Zanele puts it, Sibanye may have to navigate some difficult press articles over its pay policy until the next issue comes up. Well, as it happens, the next issue is ongoing and is one that is going to give the story it's full context. To do that, we should look a little more closely at Sibanye-Stillwater itself. The company started off not so long ago in 2013 when the South African company Gold Fields unbundled its GFI mining subsidiary. Sibanye would go on to grow its gold division, but then also branch out into Platinum Group Metals or PGMs three years later. And by 2021 into lithium as well.

Now at the time of recording, Sibanye-Stillwater is intense negotiations with mine workers in its gold mining division as part of a 10-week strike. Key unions representing Sibanye's employees are the National Union of Mineworkers or NUM and The Association of Mineworkers and Construction Union or AMCU. These two unions jointly represent around 25,000 employees working in the company's gold operations. That's around 80% of its mine workers that are chasing after gold in more than one quarter of Sibanye's total workforce.

Now, for those unfamiliar with the complex history of unions and mining companies in South Africa, unfortunately this show isn't long enough to get into all of it. It suffice it to say, it has not always been a peaceful history. Strikes have been violent and have included conflicts between different unions. Perhaps the most infamous strike in recent years was in Marikana in South Africa's Northwest province. In August, 2012, a strike by mine workers at the Lonmin Platinum Mine culminated in violent police intervention in the deaths of 34 miners.

Seven years later after facing an uncertain future Lonmin was acquired, and the company that acquired it was Sibanye-Stillwater. Now, as I'm recording this, our ESG rating of Sibanye-Stillwater sits at a double B, which is a couple of rungs up from the worst possible of triple C, but a fairway or from the best possible rating of triple A. In our rating of metals and mining companies that specialize in precious metals, we split the emphasis equally across our environmental, social, and governance pillars.

On its governance pillar, Sibanye-Stillwater actually does pretty well compared with its global peers, which is not that unusual for South African companies. In its environmental and social pillars though, the company falls short of the industry averages, particularly through low scores in the water stress, health and safety and labor management key issues. Now we touched on health and safety already, but to get a better handle on the company's labor risks, particularly in South African context, I brought in Sam Block, our mining industry lead coming fresh out of MSCI's New York office

Sam Block:

Mines in South Africa are some of the most labor-intensive mining operations around the world in terms of industrialized mining operations. A lot of these gold mines in particular were opened and designed back in apartheid, South Africa, which in a lot of ways they were exploiting the labor of Black Africans. Times have changed, but those minds continue to be dependent on being very labor-intensive. Depending on your perspective, labor-intensive operations are more likely to face layoffs. If there's a slowdown, they can shut the operations more quickly by laying people off as opposed to more capitalized, more automated operations, they kind of have to keep working.

They can't fire the equipment that they're paying off and appreciating over time or leasing. So there's actually is more likelihood that there is going to be layoffs and then rehiring maybe the next year or a couple months later because of that flexibility that they have with a more labor-intensive operation. But then, of course, these companies are going to come and face unions that are going to obviously oppose the layoffs of the workers. And so you have a lot of contentious labor relations in South Africa.

Bentley Kaplan:

Right. So given what Sam is saying, it's maybe no surprise that in our ESG ratings model, we assess mining companies on the labor management key issue. Because motivating a large workforce and staying on the right side of unions is a key operational consideration. And mine workers are not only operating in uncomfortable and dangerous positions, but in companies where job uncertainty is a real concern, tied to phrases like rationalizing and right sizing. So it's probably not all that surprising to see that the pay package of Sibanye-Stillwater CEO has been a bit of an accelerant in the back and forths between union leaders and the company.

Per the company's 2021 disclosures, the average salary for its entry level employees in South Africa was R2,170 per month, which is around $1,300. And that's roughly one and a half times bigger than South Africa's minimum wage. But unions and workers are not only looking at minimum wage as a barometer, they're looking at Sibanye's management. And there are all kinds of caveats around benefits and allowances or site specific profit sharing schemes. But if we extrapolate that basic salary into an annual salary, Froneman took home roughly 1100 times that number, which is what workers are really agitating about.

In their current strike unions are asking for an increase of R1,000 per month for three years. Now that equates to a 9.8% rise in year one and 8.8% rise in year two, and an 8.2% rise in year three. So Sibanye's best current offer is short of that, at 850 Rand per month for the same period, which still equates to a 7.8% increase in the first year, 7.2% in the second, and 6.8% in the third. Both proposals would be above the inflation target of South Africa Central Bank, which is between 3% and 6%.

But this is why I also wanted to raise an argument that's been made in defense of Froneman's pay, and I'm simplifying here. But it goes somewhere along the lines of the CEO made the right decisions under a lot of uncertainty and skepticism. In particular, he drove decisions to diversify into new minerals, which was a key driver of growth and should bode well for long term resilience. And yes, those decisions help the company perform well, and that translates into generous incentive payments. But a company that stays in business or moves with market trends like tapping into sudden rising demand for clean-tech metals is also one that can provide continued employment for its workforce, wherever union negotiations ultimately land up. And Sam had some helpful insight into how the company's efforts to diversify might ultimately play out.

Sam Block:

Gold and platinum, a lot of the uses and demand for these materials are for jewelry. And gold in particular investments and jewelry account for over half of gold demand. Industrial uses are much lower. And so from a sustainability perspective, you could argue that using platinum or platinum metals have more applications for clean tech. A lot of platinum is used now in catalytic converters, and with actually the transition to electric vehicles, you'll have less of demand for these catalytic converters.

That being said, however, the platinum is likely to be heavily in demand for fuel cell vehicles. And so there are some potentially long term benefits there for investors that are searching for suppliers of clean tech. That's going to attract platinum mining and diversified into other metals like nickel or lithium or copper could attract investors into those companies rather than a pure play gold mining company. And being diversified in general is going to lower the risks if in case there's a market slow down and for one medal as opposed to another one and may lead to that company being able to withstand slow downs in a more sustainable way, and therefore may lessen the amount layoffs they have for instance.

Bentley Kaplan:

Right. Sibanye-Stillwater may be knuckling down for a prolonged union negotiation. But as Sam puts it, the company has moved into metals that not only offer a way of diversifying risk, but also potentially capitalizing on growing demand, demand for lithium in new battery technologies or Platinum Group Metals for fuel cells. And implementing the strategic vision while navigating today's operational challenges kind of comes with the job of CEO. A job that carries a lot of pressure to be sure, but one that increasingly comes with weightier and weightier pay packets. And this trend is being barnstormed by U.S. companies and replicated in other markets.

The Economic Policy Institute reported that CEO pay at 350 large U.S. companies was 351 times larger than that of a company's average pay in 2020. And that was a steep step up from the more modest 307 to 1 ratio of 2019 with the 61 to 1 of 1989. You get the idea. And this upward trend does create a tricky situation for pay committees. We may never have a satisfactory answer to the question of how much is too much for a CEO or not enough? Because a company can hire an independent consultant and elect an independent pay committee that signs off on a number that may seem reasonable in the boardroom, but finds a much cooler reception in the court of public opinion or in the dangerous punishing conditions of a mine.

And on the flip side, there may also be no amount of post talk rationales that will convince skeptical shareholders or union bosses of the links between management decisions and stellar company performance. And even though there does appear to be some shifting more pressure from some shareholders, including asset owners to reign in CEO pay and more pressure from stakeholders, ultimately, this is a big shift that needs turning around and it may be sometime yet before we see more measurable changes.

And that is it for the week, a massive thanks to both Zanele and Sam for their take on the news with an ESG twist. What I've cut into today's show was taken from much longer interviews and it broke my heart a little to have to leave so much behind. But we know our listeners like to keep things short and sweet. And on that note, thank you very much for spending your precious time listening to our show, smack down some stars and reviews of the urge takes you. And please do send us any feedback or ideas for future shows. The fearless mic, we'll be back again with you next week.

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