Private equity driving up pay

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GENEROUS private-equity pay schemes for
senior executives, in which managers frequently receive up to 15 per cent of a company's shares, would be mimicked by publicly listed companies, according to a new report.

The report into executive pay in Australia released yesterday by PricewaterhouseCoopers speculates that private equity bids, whether successful or not, would change the asking price for managers in publicly listed companies.

"Where a private equity bid for a listed company has failed, the listed company will need to give serious consideration as to how they are going to continue to motivate and retain their key executives," the report states.

"This is because these executives are likely to have been excited by the leveraged private equity remuneration model and may not be satisfied with a continuation of more conservative pay structures and levels."

The vast gulf between pay scales for senior executives in private equity firms and publicly listed companies was revealed in the failed bid for Qantas.

As part of the proposed deal, Qantas senior managers were slated to receive up to a 100 per cent bonus on the cash component of their annual base salary, increasing to a 200 per cent bonus in 2007-08.

In addition, senior managers were to receive shares that could convert into a 4.5 per cent stake in the airline.

In the case of Qantas chief executive Geoff Dixon, his long-term incentive package could have reached as much as $60 million. In contrast, under publicly listed ownership, Mr Dixon reported a salary of $5.3 million in 2006.

The PwC report notes private equity's system of low base salaries and high equity ownership promotes an "ownership" culture and a focus on long-term performance.

This contrasts with publicly listed companies in which shares form a relatively small component of a manager's overall pay.

But the report notes a vital feature of many private equity pay structures is the notion of "sweat" equity: that managers are expected to buy into the private equity company, risking their own money and suffering if there is a downturn.

The report is largely silent on how public companies can achieve this effect.

But it noted an unprecedented experiment by former Optus owner Cable & Wireless in which senior executives had been offered "private-equity style" cash bonuses of up to £20 million each if the share price doubled over a specified period.

Another 50 managers would share £180 million if the same target was reached.

The report speculates that listed companies will consider adopting some form of remuneration "hybrid" to capture perceived advantages of private equity pay structures.