Assessing corporate governance and executive remuneration using share option plans

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Abstract

The modern global business environment pays much attention to the compensation of top-level managers and CEOs. It is common news in the global media that the compensation of many CEOs is rising at alarming rates, often far exceeding the rate of corporate earnings. This article provides an explanation of share options (stock options) and the role of corporate governance in South Africa and highlights the challenges and problems that the trend of high CEO compensation is posing to companies given that owners, boards and managers often battle it out to exert their preferred stand in this regard. Companies must espouse strong values that shareholders and stakeholders approve of and make CEO remuneration a sustainable part of a business management model. In recent times there has been a trend to pay CEOs million rand salaries, as part of the shareholder value ideology and this has led to their salaries skyrocketing. This is an attempt to limit the agency problem that exists between principals and their CEOs and directors and is a governance mechanism that thus tries to align the interests of principals and CEOs through salaries, bonuses and long-term incentive share options. Effective corporate governance frameworks must be in place and the mindset of incrementalism must be reconsidered at a time when shareholders are increasingly realizing that they have real power and desire real growth in their investments and when other stakeholders feel sidelined. Areas for further research on corporate governance and compensation with respect to processes of governance, executive remuneration and financial reporting are also investigated.

Key words: Corporate governance, packages, King Reports, share options, boards, ownership, executive remuneration, financial reporting.

Introduction

“Larry Ellison doesn’t really need the money - as the co-founder and long-reigning CEO of data company Oracle, Ellison is the fifth richest man in the world with a personal worth of $43 billion. Still, a few pennies more can’t hurt and he managed to improve on the $77.6 million he was paid in 2011. The following year Ellison got a pay cheque worth $96.2 million - that’s right, he is a hair away from earning $100 million annually. Yet Ellison only earns a dollar as a salary. His bonus of $3.9 million isn’t bad, but well below the $13.3 million he got in 2011. So what made the difference? Stock options worth $90.6 million. Nice”. (http://businessnews.howzit.msn.com/the-best-paid-american-ceos)

A wide range of corporate scandals in the last few years has prompted a policy and research focus pertaining to executive remuneration and using share options and awards and corporate governance (Keasey et al., 2005). Not surprisingly, much of the focus was on big listed corporations (Gabrielsson & Huse, 2002). How can extremes and obvious excesses such as in the quote above be justified when billions are starving across the globe? Many of the global scandals also raised issues as to whether executive remuneration including share options plans, rather than solving agency problems, are in essence leading to new conflicts of interest arising between CEOs, boards of directors, shareholders and stakeholders.
This article seeks to throw greater light on employee share options (ESOs) and corporate governance in a sample of organizations many of which are large and established operations (some Multinational Corporations) as well as smaller middle-sized operations. The stakeholder-agency theory and the stakeholder theory in which there is a distinction between ownership and control (Shleifer & Vishny, 1997) are also assessed briefly in this article. However it is especially the use of share options plans as an effective incentive that seeks to align the interests of principals and CEOs as well as talent management mechanism that are examined. There is great research interest in corporate governance and this tends to focus particularly on the role of boards (Venter et al., 2003). The role of boards and their external directors, as well as the role of owners, and other governance mechanisms such as executive remuneration and especially share option plans, and financial reporting and auditing are also the objects of recent research initiatives (Keasey et al., 2005).

Share options are usually granted under company share option schemes and give the holder, usually the CEO (agent) and/or certain directors, the right to buy shares at a fixed price which is generally the exercise price (current market price) or strike price of the option at a time between two fixed dates. Share options are also usually awarded on a rolling basis and new awards are made at earlier intervals. The profits made are taxable compensation. In the United States, CEO pay has risen to levels which are often way beyond what can be justified by changes in organizational size and performance. It is extremely excessive and often rewards failure.

![Figure 1. Ratio of average compensation of CEOs and production workers, 1965-2009.](Economic Policy Institute. 2011. Based on data from Wall Street Journal/Mercer, Hay Group 2010)

Definitions of what corporate governance entails often vary. For the purpose of this article, corporate governance refers to the principles, systems and processes by which a company is administered. Business policy should include systems which incorporate mechanisms for all the shareholders including the external stakeholders (Freeman and Reed, 1983). Fama and Jensen, (1983) and Donaldson and Preston, (1995) who promote the stakeholder theory and Hill and Jones (1992) with their stakeholder-agency theory support this notion.

Corporate governance gives the guidelines as to the manner in which a company is directed or controlled so that it is able to fulfill its goals and objectives in a way that adds value to the company. This must also benefit all shareholders (Keasey & Wright, 1993) as well as stakeholders including the
suppliers, customers, stockholders, employees, financial institutions, the media, political action groups, communities, and governments. Financial returns to stockholders may be important but not at the expense of the shareholders. It is thus critical that for the long term the strategies implemented by an organization should reflect the way in which it intends to grow, its structure, control systems, and even its operating culture. Good corporate governance ensures corporate success and leads to economic growth as it keeps the investors' confident and this makes for example, the raising of capital for projects easier. Corporate governance provides inducements for owners and managers to achieve the predetermined objectives that are generally in the interests of the organization, shareholders and stakeholders. There are other interpretations of what organizations actually are, for example they are viewed as totally independent bodies which pursue only what is good for themselves (Filatotchev & Wright, 2005; Blair & Stout, 1999).

The Stakeholder Theory

Shareholders should nonetheless no in any sense be disenfranchised to the benefit of other stakeholder groups but the latter should play some part in the corporate governance process. The extent to which they participate will be dependent on the broader legal and political environment in which the organization functions and more especially the law and moral and ethical correctness. The nexus of laws impacting firms in any country matters for the analysis of corporate governance. A good normative argument can be made for a strong stakeholder perspective, and in many countries stakeholders do take part in the decision-making process of an organization within legal limits of course.

A clear difference exists between definitions of who the stakeholders are in any organization. Freeman postulated the theoretical approach in 1984 which differed from the Corporate Social Responsibility (CSR) approach by not simply focusing on the corporation and its wide range of responsibilities, but by looking carefully at the various groups which have a legitimate interest in an organization and what and how it does what it does. The basis for stakeholder theory is that organizations are generally so big and their impact on society is far more insidious than one would imagine. Consequently they should be far more accountable to society than simply demonstrating concern for their shareholders. There is also a business case in considering the needs of the stakeholders through obtaining supplier confidence and enhanced customer perceptions as well as more highly motivated employees.

The conventional input-output model of an organization which considers businesses to be converting investor, supplier, and employee inputs into customer outputs (Donaldson & Preston, 1995) is taken a step further. In terms of the Stakeholder theory every authorized employee or groups of employees who take part in the business of the organization do so to obtain certain benefits not all of which are self-evident. Stakeholder Theory is also more normative. A group of stakeholders may of course have duties as well as obligations to their own stakeholders and so a network model exists (Rowley, 1997). A model of a corporation is thus arrived at which serves the purpose of providing a framework for investigating the linkages between conventional organizational performance and the practice of stakeholder management. Those who are considered to be stakeholders may be recognizable by their special interests and all stakeholder interests are considered to be intrinsically valuable (Donald & Preston, 1995). Clarkson (1995) defines stakeholders as the people who have or may claim ownership, rights or even
interests in a corporation and its various activities.

Stakeholder theory is the most popular and influential theory to arise from business ethics (Stark, 1994.) It has been expressed in various ways. What is common is that in whichever way, stakeholders represent a broader community for corporate responsibility than only stockholders.

Stakeholder Theory is in a sense a managerial tool in that it recommends that attention be paid to the interests of all stakeholders including the government, investors, political groupings, suppliers, buyers, employees, the community at large as well as trade associations. Attention is paid to the attitudes of employees, the structures and processes as well as practices of an organization.

![Figure 2. The stakeholders of the modern organization](image)

There are undoubtedly disparate views on stakeholder theory. Many question the notion that it is primarily an organization’s responsibility to provide its stockholders or owners with profit. Milton Friedman (1970) maintained that it is an organization’s duty to act responsibly and thus also consider the welfare of non-stockholders. It is apparent that the stakeholder perspective, especially when taken to extremes, has its risks. However, any deviations from shareholder and stakeholder value, may empower management to hide behind a wide range of self-seeking objectives.

Agency theory is a contracted variety of stakeholder theory where there is a separation between ownership and control. Separation of ownership and control often leads to a potential conflict of interests. In such a scenario, the CEO of an organization for example, is an agent who is employed by a principal to conduct tasks and manage an organization on their behalf. The term ‘agency’ implies that a relationship exists between a principal and their agent. The agent is thus accountable to the principal who employs him/her. The Agency theory is thus primarily concerned with the resolution of problems that may arise during the course of the agency relationships, that is, between principals (including the shareholders) and agents of the principals (for example, Chief Executive Officers or company executives). Problems may arise due to inter-alia, inefficiency on the agent’s part, different attitudes between the principal and the agent on risk issues,
incomplete information, different goals for an organization or the way in which transactions are handle with a third party (http://www.investopedia.com/terms/a/agencytheory.asp). The agent may have totally different objectives in mind including a desire for an elevated salary, large bonus and greater status as a director. This may differ considerably from the principal's objectives which could be the maximisation of profits for the shareholders (Grossman & Hart, 1986). The CEO and directors of an organization are expected to conduct business ethically and with integrity and fairness. They should be accountable, responsible and transparent in all the transactions they undertake and consider all stakeholders (Thomson & Bureau, 2009).

Corporate Governance and the CEOs role

Corporate governance should be what ultimately defines the principles of responsible leadership, sustainability, consideration of all stakeholders and corporate citizenship into tangible governance in organizations. It is a tool containing the processes and structures to help endow the foundation with responsible and accountable leadership embued with corporate citizenship that considers all shareholders and stakeholders (OECD, 1999).

Cannon (1994) states that the effective governance of an enterprise is in control of the activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership and control. It incorporates the trusteeship of assets, their management and their deployment. The aim of corporate governance is to align as closely as possible the interests of individuals, corporations and society (King Report on Corporate Governance, 2002) (Ehlers & Lazenby, 2010). Corporate governance thus involves “holding the balance between economic and social goals and between individual and communal goals ... the aim is to align as nearly as possible the interests of individuals, corporations and society” (Ehlers & Lazenby, 2004). Corporate governance assists CEOs and directors to be able to distinguish between personal and corporate funds used while in the process of managing an organization (Thomson & Bureau 2009). However there is much research which demonstrates that highly fraudulent behaviour can be directly associated with share option incentives that CEOs receive. This is more especially the case where the CEO and board members also have share options and even more so when the CEO is the chairman of the board of an organization (O’Connor et. al. 2006).

Privately owned organizations firms including family businesses tend to rely on informal social controls rather than on any contractual governance. In fact family owned businesses are often characterized by formal contracts, incentives and carefully designed monitoring systems (Jensen & Meckling, 1976). Running organizations’ ‘properly’ requires integrity and morally correct behaviour and it thus rapidly enters the sphere of Corporate Social Responsibility and ethics. Consequently the task of especially the CEO of an organization and he/she should make it clear that profit is generated but that this is not at the expense of all the stakeholders in society and the environment. This is thus a daunting task as the CEO is not merely an ‘agent’ recruited to increase profits, but is rather tasked with benefiting all stakeholders in the organization’s network and to being accountable. Corporate Social Responsibility (CSR) is thus made an aspect of policy and put into practice not merely as a façade (Feizizadeh, 2012). There are of course many CEOs and executives who pursue the interests of the organization even though this may be at odds with their own interests (Donaldson & Davis, 1991).
The separation of the goals between the wealth maximization of the shareholders and the personal objectives of CEOs is a key assumption of Agency theory. CEOs should thus seek to protect the interests of shareholders and stockholders and not strive for additional personal enrichment. However this is not always the case and the separation of ownership and control in an organization often leads to conflicts of interest between directors and shareholders where the former strive for self-enrichment above everything else. Principals need to find ways to ensure principals act in their interest as well as those of all stakeholders. Effective ethical governance is thus major issue for the CEOs and directors of many organizations. The dominant focal areas are on ensuring that companies are effectively directed and controlled and that CEOs and directors act on behalf of all their stakeholders and shareholders. CEOs and directors as well as managers operate as agents on behalf of the principals or shareholders of an organization. There is thus a contractual view that assumes that both parties perform in their own welfare. In this arrangement, corporate governance is regarded as a method by which owners may direct and control the operations of the organization (Ehlers & Lazenby, 2010). The organizational rewards including share option plans given to CEOs and directors which impact on the organization in terms of corporate governance and the stakeholder and agency theories must therefore be carefully considered.

**Share option (stock option) plans**

Maharaj, Ortlep and Stacey (2008) state that employees tend to develop a positive relationship with employers based on a pattern of expectation they have on their employers. Once their expectations are not fulfilled, it becomes clear that employee commitment tends to diminish. Kruse (2002) contends that employees work much harder and are likely to be more attentive to issues of quality at work than otherwise when they are given share options. Albaraccin, Johnson and Zanna (2005) state that employee attitudes and perceptions tend to show their vision and values that drive them to make the decisions that they do make. Positive attitudes are bolstered by share option offerings.

To ensure that CEOs and other directors do not abuse their powers and be tempted to indulge in unethical conduct it is often desirable to provide them with share or stock options incentives as explained earlier, which is already an acceptable global practice (Leape, 2006). Share options serve a purpose of making the share holder wealthier and also align the interests of the option holders with the shareholders as they all have an interest in the shares going up in price since the greater the price increase the greater the profits that will be derived. If the market slumps and share prices drop, the share option holder does not ‘cash in’ but rather exercises the right when the market is bullish.

However, share options are usually considered to be long-term compensation and executives treat these as part of the compensation which they ‘earned’ and almost always exercise the option to sell shares when this becomes a possibility. Some share option plans seem to be well designed and the option strike prices may be much higher than the current price of shares. Share option re-pricing takes place in high risk situations or when the organization’s performance is poor. This is done to restore the incentive effects of the share option and even backdating may result (Klausner, 2007). Share options plans are often used as a recruitment tool in many countries (Rousseau & Shperling, 2003).

Share option plans became the mechanism which is used in many organizations to pay CEOs and often other directors and even
mid-level managers higher levels of compensation. However, for this concept to work it would not be sufficient to pay them with only a few shares but with enough to make them far wealthier and so huge share option deals are arranged for them. Grigoriadis and Bussin (2007) explain that many companies cover executive staff as well as middle management by offering them share options but with BBBEE it is now necessary to begin to consider all employees. There is certainly a need to research if there are differences in expectations amongst employees who do have share options and those who do not. Joensson (2008) maintains that employees view their social identity as being derived from the status afforded to them by inter alia, employers. The share option plans generally thus seek to win hearts and minds of employees, but also seem to impinge on employee attitudes due to their intrinsic nature which provides a sense of ownership and power. There is also the undoubted extrinsic value of financial gain which they desire to achieve. When new shares are issued under option schemes, the earnings per share are diluted and the existing shareholders suffer since the CEOs gain is the shareholders loss as earnings are reduced. This is why in South Africa, International financial standards reporting (IFRS) is followed by listed companies since January 1, 2005. This necessitates that share options be reflected as cost/expenditure against revenue. Often when shares are granted in large blocks to CEOs there is fraudulent activity as profits are manipulated so that the company’s financial performance looks rosy. This often results in shares obtaining an upward impetus based on false numbers (Kneale, 2011) and is thus fraudulent activity.

The latter is often at the expense of stakeholders, which is why more effective corporate governance is required. If organizations are to have compensation plans including share options, there needs to be additional monitoring and this will in itself increase the costs of agency. The agency theory results in problems as the interests of CEOs for example and principals do not always align. The compensation should in all cases be linked to measurable outcomes including especially the financial outcomes over a prolonged period of time. CEO share option plans vary considerably by region of the world. The United States is the highest payer of CEOs and in this country some 14.6 million employees had share options in their organizations in 2004 (National Center for Employee Ownership, 2004). These are essentially a common form of long-term market-orientated incentive scheme. The share options allow CEOs and directors to purchase shares at a fixed price so that once the shares rises above the purchased price the CEO and directors can sell the shares and generate an often huge profit. Executives generally receive annual compensation as well as long-term compensation in their remuneration package. In 2008, the CEO of Porsche, Wiedeking, receive an annual earning estimated to be 77 million Euros (Focus 2009). A 2008 survey in the United Kingdom uncovered that Lonmin’s American CEO took home a total pay package of £8.2m. This huge salary was 790 times the average wage of £10,410 among his 24,122-strong workforce many of whom are employed at the Marikana and Limpopo mining operations in South Africa, where ore containing platinum group metals is extracted (Guardian 2008). There are of course many such huge pay ratios in especially the service and retail sectors where there are millions of low level wage earners. Are salaries such as these remotely justifiable? Generally speaking, the contributions of chief executives are overvalued to say the least.

Human capital is an ever-increasing source of differentiation between companies. There are however limited supplies of talented CEOs and directors and so the principals of organizations are on the lookout for efficient
and effective employees and use share option plans as a mechanism to recruit and manage and motivate talented employees who are of greater value to them (Rueff, 2008; Faragher, 2007). Share options provide the CEOs and directors, the incentive to manage an organization in such a way that share prices are likely to increase leading to greater profits. Consequently, share options plans are assumed to bring into line the CEOs and directors goals with those of the shareholders. An agency problem should thus not exist as in such a scenario the CEO and directors become the ‘owners’ of the organization. It is clearly time for corporate governance reforms which is why the US President Barack Obama announced in February 2009, his desire to cap salaries at $500,000 on all companies obtaining federal support funding. This would in effect oblige executives to accept very large pay reductions and they would also be prohibited from receiving additional bonuses above their basic pay, but would be able to retain usual share dividends within reason (Houle, 2009).

What some senior employees think about share options and corporate governance

Methodology

Purposive sampling is very useful for situations where one needs to reach a targeted sample quickly and where sampling for proportionality is not the primary concern. One of the first things the researcher did was to verify that the respondents do in fact meet the characteristics or criteria for being included in the sample. They were purposively selected because they met the main characteristic of being recipients of share options (Patton, 1990). Purposive sampling techniques thus involve selecting certain units or cases “based on a specific purpose rather than randomly” (Tashakkori & Teddlie, 2003). The researcher used a very simple purposive sample interview survey methodology (key informant) and distributed surveys to 800 CEOs from medium and large sized enterprises, including multinational corporations, each were required to respond on the issues of share options and corporate governance. An introductory email was sent to the organizations concerned as a follow up prior to information being collected. Clarity was provided on what was expected and respondents were in no way obliged to answer any questions and did so voluntarily. Language barriers were not a problem as all of the respondents were fluent in English. Questions were structured in such a way that responses could be easily compared. Included were closed and open-ended questions. The response rate was 25% (n=200). The respondents were either CEOs, senior managers or executives in each of the respective organizations. The industries covered included banking (20), medical (20), hotel (30), media (10), construction (10), mining (20), pharmaceutical (10), leisure (10), wholesale and retail (40) and education (30). In terms of ethicality, all questionnaires were designed to ensure that the respondents remained anonymous so as not to compromise them in any way. Respondents were made aware of their rights and had to sign a consent form that was provided with the questionnaire. Organizational names remained undisclosed throughout the research.

Twenty questions excluding biographical data were constructed with part of the responses based on a five point Likert scale (Strongly disagree, disagree, neutral, agree, strongly agree). The instrument was reliable in that it yielded consistently similar results when the entity measured remained constant (De Vos, 2002).
Table 1. Demographic composition of the sample (n=200)

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<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percentage</th>
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<tbody>
<tr>
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<td>66.5%</td>
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<tr>
<td>Female</td>
<td>67</td>
<td>33.5%</td>
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<tr>
<th>Age</th>
<th>Frequency</th>
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<tr>
<td>36-45</td>
<td>42</td>
<td>21%</td>
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<tr>
<td>46-55</td>
<td>29</td>
<td>14.5%</td>
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<tr>
<td>56-65</td>
<td>111</td>
<td>55.5%</td>
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<table>
<thead>
<tr>
<th>Ethnicity</th>
<th>Frequency</th>
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<tbody>
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<td>47.5%</td>
</tr>
<tr>
<td>White</td>
<td>82</td>
<td>41%</td>
</tr>
<tr>
<td>Coloured</td>
<td>11</td>
<td>5.5%</td>
</tr>
<tr>
<td>Indian</td>
<td>3</td>
<td>1.5%</td>
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<tr>
<td>Oriental</td>
<td>9</td>
<td>4.5%</td>
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The majority of share options recipients were male, over 55 years of age and mainly blacks and whites. Many of these had certificates or diplomas (n=74) while some had degrees and postgraduate qualifications (n=39). Interestingly, only a few (n=84) had completed qualifications where financial management was included as a course. 43% (n=86) of respondents had been with their current company for at least the last 5 years and 27% (n=54) had been with the company for more than 10 years.

The researcher attempted to gauge the attitude and behaviour of the respondents with regard to agency and whether or not there is any consideration on their part of all stakeholders in the managing of their respective organizations. It appears, according to the interviews and the literature reviewed that employees are in favour of share options (Bucko, 1993) and are more likely to be more committed to their work and have a positive attitude as a result thereof (Klein, 1987). For some CEOs, share options are the only meaningful incentives and some of them possess so many shares that they do not believe that they receive more meaningful incentives from variation in their annual pay. This makes it highly improbable that anything other than changes in the share price will indeed motivate the CEOs. (http://knowledge.wharton.upenn.edu/article.cfm?articleid=526). After analysing the survey sample responses of CEOs (n=200), on the value of share options, it was possible to conclude that they have a number of extrinsic as well as intrinsic values. Some CEOs felt that they were in a position to greatly influence the course of events in the organization due to their shares held (n=58). Others felt that they were proud to be regarded as part-owners of their organizations and had vested interests. Furthermore share options instilled them with a sense of pride and achievement (n=142) and created opportunities for creating long-term capital based wealth (n=127). Some regarded the share options as a ‘savings plan’ (n=71). Some CEOs (n=77) would probably prefer to own shares directly rather than have share options.

Four CEOs did not receive share options and would if give the opportunity seek employment in a company where share options were on offer. Most of them felt pleased about the prospect of greatly increased compensation even though it would be deferred (n=126). Half of those interviewed felt they were more committed
and intended to stay with their employer due to the share option plan they had and would need to carefully consider moving to another company \((n=102)\). The majority of CEOs \((n=153)\) felt that share options built a team spirit and served as a motivator to perform well at work. All of those who received share options regarded them to be the preferred reward mechanism. Interestingly a number \((n=52)\) although happy with share options, would prefer the work environment to be more quality orientated and would also prefer to have opportunities to develop themselves whilst making more money. Some respondents \((n=33)\) that share options did lead to inflated profit figures in other organizations and that this was misleading investors.

Surprisingly only a small number felt they were obliged to deliver the goods in their current positions and were keen to meet existing obligations \((n=71)\). This group concurs with the findings of Rousseau and Shperling (2003). In regard to the latter, one would imagine that all of them would share the same sentiment. The results however generally strongly suggest that the ethic of self-preservation and a spirit of entitlement pervade the thinking of most CEOs and that only a few feel bound to perform effectively in terms of a psychological contract with their principals. This concurs with the findings of Bucko (1993). This same group also stressed that they had close working relationships with their boards of directors but perhaps more was needed. The is however a need to take the concept of corporate governance in organizations further than boards alone and this notion is supported by research conducted by Hessels and Hooge (2006).

Half of the respondents \((n=90)\) felt that they did more than enough to consider all stakeholders and were involved in corporate social responsibility initiatives, but they did not appear to grasp the full extent of what stakeholder theory actually implies and to most, this was a necessary façade to appease certain stakeholders namely government. It thus seems that ethics and business do not exist in harmony as they should. A number \((n=11)\) had concerns with regard to issues of trust and confidence which was apparently lacking in their relationship with the board of directors. Some \((n=54)\), questioned the perceived and authentic independence of the auditors used to monitor their progress. Three suggested that a recent number of high profile corporate failures have clearly shown that a major component of running a business lies in controlling risk but they were averse to being ‘spied on’. The system of internal controls including internal audits thus appear to be insufficient in some organizations. Two CEOs believe that in some organizations in which they previously worked, share options were simply used to discriminate amongst employees.

A large number \((n=146)\) felt that companies are now demonstrating a greater sensitivity to coalescing ethical issues with commercial achievement but that this is very difficult to do in an environment where corruption is an ever-increasing problem in respect of, for example, granting of huge tenders. The likelihood of bribes being considered is greater now than ever before and so CEOs are called on to have strong moral compasses and avoid ethical dilemmas and moral mazes. A number of respondents \((n=47)\) felt that their company was using share options simply to protect its image and that this was in line with what they thought was Broad Based Black Economic Empowerment (BBBEE). Over half of the respondents \((n=11)\) felt that participating in share options was a good opportunity to build financial empowerment. Certain CEOs \((n=32)\) believed that educational qualifications should also be used as a criteria to evaluate how many shares an employee should receive.

CEOs believe that they are accountable and that this is part of what is viewed as a
corporate governance (n=156). The need to be monitored, evaluated and controlled as agents is 'a given' so as to ensure that they act in the interests of all stakeholders but especially the shareholders. This confirms the findings of Keasey and Wright, (1993). Certain CEOs (n=101), felt that they were hampered in their efforts to act entrepreneurially and be as innovative as they deemed necessary at times, so as to assure that shareholders and stakeholders actually benefit from the upside potential of the organization. Corporate governance should be appropriate and mechanisms should be in place to support CEOs more rather than serve as a 'control tool'. The elements of organizational effectiveness that should be monitored vigorously were believed to be financial performance and strategic management taking into account the generation of millennials. The internal governance instruments such as share options and financial reporting as well as the accessibility of required information should also impact the way in which corporate governance is handled and should thus be carefully considered. Uhlaner et al. (2007) have predicted facets of organizational effectiveness, including strategic change and financial performance that could be worth noting. The study was limited in light of the fact that different types of share options operated differently and had different objectives.

Why share options are not advisable

A study by Wasserman’s (2006) represents a fascinating development in distinguishing between a suitable reward-system for agents such as CEOs in terms of the share option versus cash balance in compensation. CEOs and directors receiving share options need to be responsive to shareholders and stockholders and not simply be concerned about stock prices that impact them personally. There are those who argue that when share options are part of the remuneration package of executives, they are more likely to be concerned when the value of shares is plummeting on the stock exchange. Share prices are ascertained by the earnings and returns that employees generate in the long term, however in the short and term shares are volatile and may move for a variety of reasons that are not linked to a company’s performance. There is often immense pressure on CEOs to manipulate share prices in order to increase the value of their options. Every now and then company internal control systems and corporate governance fail which allows management to perpetuate fraud which means that managers can manipulate the share price for self enrichment. While corporate governance initiatives may be in place, these are not always adequate to control or regulate what happens to shares with regards to manipulation by executives who have huge volumes to sell. It is also problematic that in many companies, the CEOs have greater power than the boards of directors. Critically, the desired culture of ownership and CEO accountability is not always the result of share options.

So, it is often the case that a CEO unethically predicts that a share price will rise steeply so that greater interest may be generated in the purchasing of more shares so that their shares obtained by share options, may be sold when a desired peak price is attained. After their sale of shares, the price of shares may plummet within days and this is then blamed on exogenous factors that have adversely influenced the prices. It was commonplace in the 1990s, that many CEOs and other share option holders obtained inordinately large increases in their remuneration despite the highly mediocre or poor performance of their companies. As interest rates were lowered and risk aversion fell, investors found that they were paying higher prices for shares (Fink, 2009). Consequently share prices increased even in poor performing companies. The global economic slump since 2008 has witnessed most stock prices...
plummeting. Employee share option plans are risky as they do not in most cases align the interests of employees that receive them at whatever level. CEOs should be limited to selling only certain amounts of shares when share prices suddenly climb and the way to implement controls of such a nature would be to hold all executive share options in a trust account (Kneale, 2011). The listing requirements of the Johannesburg Stock Exchange (JSE Ltd), Schedule 14, provides that executive directors may not be trustees of share options schemes, and only non-executive directors who do not benefit from a share option scheme would qualify to be trustees of a scheme. Furthermore, shares held by a company’s share trust shall not exceed 20% of the issued share capital (Kneale, 2011).

One would imagine that share options for CEOs and directors would give them an incentive to become more productive and efficient and consider all stakeholders in the process however the opposite is often true. In the case of start-ups, paying in shares is the primary exception to the rule. Paying in shares makes more sense in this case as start-ups generally battle with cash flow to pay employees, so shares may often be the only option (Fink, 2009). Executives should only gain financially if the shares of their company outperform the market or a peer group. By indexing a situation can be avoided a where executives profits if the share price goes up 5% even though the market as a whole rises by 12%. There are supporters of the notion that if shareholders benefit, so should their executives, even if the reason is overall aggregate market movements or economic trends over which shareholders and executives have no control (http://knowledge.wharton.upenn.edu/article.cfm?articleid=526). When considering share options as compensation, principals should stretch out the exercise period of the share options or even award restricted shares that have long-term vesting. This will to an extent ensure that these professional CEOs consider all stakeholders when “cashing-in". The board of directors should also be in a position to scrutinize the CEO’s portfolio to see how much he or she has invested in the share price. Research has shown that once CEO wealth is too highly concentrated in shares, CEOs may undertake diversifying acquisitions, which will in turn have the effect of lowering their risk but this also then reduces firm value.

The shareholders should be able to approve the grants to CEOs on an individual basis rather than the principal granting sole approval for share options in general. When CEOs are paid in share options this tends to divorce pay from performance and so efficiency and productivity decline. The business cycle must be considered first and foremost and the effectiveness of employees’ efforts must be carefully weighed up (http://www.businessinsider.com/2009/2/why-stock-options-suck).

**The cost of agency relationships**

The principals of companies are constantly monitoring the activities of their CEOs and this is a very costly exercise. In this exercise, the CEOs as agents are obliged to spend much money and time on inter-alia, carrying out certain related tasks including developing incentive schemes and remuneration packages for the directors on the board. Meetings have to be held with financial analysts on a regular basis and very often also with shareholders. In the process, many CEOs purchase for themselves expensive aircraft and motor vehicles which are essentially additional costs incurred by the company and thus represent a loss to shareholders. It is thus critical to conduct regular meetings between all the directors and major institutional investors and broader key stakeholders all of whom should have voting rights at the AGM in support of, or against, any resolutions that are to be passed. Additional
regulatory processes may need to be implemented of shareholder actions are not adequate. CEOs should thus be bound to codes of conduct and recommendations that may have been made by governmental bodies and the stock exchange. Compliance should however be voluntary and not legally enforceable. It is likely that the CEO will abide by such rules as failure to do so would clearly result in the share price dropping (http://kfknowledgebank.kaplan.co.uk/KFKB ). The main task of corporate governance efforts should be to control CEO opportunism and empowerment to make decisions about real value distribution.

The King Reports on Corporate Governance in South Africa

South Africa is making strides to align corporate governance with international standards. Consequently a series of reports was developed after intense research by Mervyn King a former Judge of the High Court of South Africa and a committee he chaired on the issue of Corporate Governance in South Africa. The first of these was termed The King I Report, and was published in 1994. This report interrogated the basic principles of good financial, social, ethical and environmental practices and discussed aspects beyond the usual financial and dogmatic facets of corporate governance. The report called for an integrated approach to good governance taking into consideration the interests of all stakeholders, not only the CEO, board of directors and shareholders. The responsibility toward shareholders in terms of financial issues and ethical standards in organizations was elaborated (Ehlers and Lazenby, 2004).

A follow-up King II Report was published in 2002, which substituted the 1994 report. This report exceeded issues on the requirements of the Companies Act of 1973 and integrated recommendations that the committee made on the workings of a Code of Corporate Practice and Conduct for organizations. Seven key areas of ‘good corporate governance’ were identified, namely, accountability, discipline, transparency, independence, responsibility, fairness and with an emphasis on social responsibility. This report thus resulted in minimum standards of corporate governance (Ehlers and Lazenby, 2004) where the needs of all stakeholders need to be considered. In terms of this report, corporate discipline is a critical need on the part of a company’s senior management and they should be obliged to adhere to behaviour that is universally recognised and accepted as proper and correct. Transparency and independence to avoid potential conflicts of interests that may exist must be avoided. CEOs and boards need to be accountable for their decisions and actions and mismanagement must be penalized. All shareowner interests must obtain equal consideration, whether small or large. Critically, companies must be aware of and respond to social issues, and they should place a very high priority on the maintenance of acceptable ethical standards (Ehlers and Lazenby 2004). In the Share Options Code to the King Report of 2002, there is a recommendation that re-pricing of any share options requires shareholder approval as does any discount to the ruling price.

A third report on governance (King III Report) was drafted in 2009 due to the anticipated new Companies Act and modifications in international governance tendencies. The Draft Report and the Draft Code were released in February 2009. It suggested that executive remuneration be fixed by stakeholders and there should be a risk-based approach as opposed to pure legal compliance. Thus integrated reporting is required where explanations for any looming or existing financial crisis need to be provided. Not surprisingly, in terms of stakeholder theory, sustainability, ethical conduct and new era risk including reputation, are considered to be basic
concerns. With regards to effective governance, internal audits need to play a part in weighing up controls to be adopted (Ehlers & Lazenby, 2004). Transparency and high principles of corporate governance are non-negotiable as is the need to develop the competitiveness and growth of the South African economy through especially the promotion of the growth of new enterprises and by promoting entrepreneurship and creating new jobs. Steps would also be taken to simplify the modus operandi for creating new companies.

Corporate governance may contribute to value creation in diverse ways. It is certain that it impacts both economic stability and growth prospects (Ehlers & Lazenby, 2010). Boards of directors have made great contributions in especially start-ups (Clarysse et al., 2007). They also play a significant role in forging the strategic orientation of a company (Brunninge et al., 2007). There is a huge necessity need for the extent of governance in organizations to be widened so as to include more controls on inter alia, ownership and control, financial reporting, share options, and stakeholder and agency theory. It is also important to have a group of independent directors on the board as this generally contributes towards ensuring confidence in the market to the benefit of the organization.

Conclusions and recommendations

This research established that there are generally positive perceptions about employee share options and that in certain cases these motivated employees to remain committed to their company, principal and shareholders. Problems could however arise when other stakeholders are not considered. Care must thus be taken, to make share options viable and sustainable when it comes to obtaining the buy-in of all stakeholders. Share options should also not simply be a façade of supporting BBBEE so as to comply with legislation and be discriminatory in any sense.

Much of the theory in corporate finance assumes that organizations function under the constraint of an efficient and effective civil and criminal justice system. This is however clearly not the case in some environments where there is outright and large-scale fraud and theft is accepted as a standard operating procedure. Fortunately South Africa is not at this juncture yet. The findings of this article suggest that share option plans are very popular as a way of compensating certain CEOs and directors and they link pay with performance and invariably have important implications for organizations. Share option incentives are used to align the principal's, CEO's and shareholders interests but salary levels have consequently rocketed and not all stakeholders benefit. In fact there is usually strife in organizations as a result and this in turn leads to share prices dropping. When shares drop, CEOs tend to lose interest and are not generally fired-up as when shares are climbing steeply and thus more vulnerable to the possibility of acting unethically. The predominantly American-British shareholder value orientation and the offering of share options to CEOs and directors often have a negative impact on developing nations. The boards of directors do often not have the requisite influence to curtail self-seeking CEOs who espouse the ethic of self-preservation at all costs. Where the principal of a company demonstrates commitment there is greater firm performance (Uhlaner et al., 2007) and less likelihood of the CEO being able or willing to abuse authority. Researchers have discovered that CEOs rewarded predominantly with share options relative to restricted stock were more likely to make poor acquisitions, had more hits and misses that led to more volatile financial results, and were even acknowledged as having more accounting irregularities (Finkelstein, 2009).
The pay of CEOs and directors should be performance related in a world where shareholder value is growing but share options should be carefully considered in any overall remuneration plan, and incorporated into existing reward schemes, but not to the detriment of any of the stakeholders. Executives should be rewarded well but this should not be excessive and they should be totally accountable and ethical in all their processes and transactions. It is advisable to conduct sufficient groundwork so as to try to establish which incentives CEOs would in fact prefer and when share options are sought why is this indeed the case?

The role and functions of a board in corporate governance need to be clearly spelt out but essentially it should serve as the focal point for Corporate Governance and ensure that the company acts and is seen to be a responsible corporate citizen which considers all stakeholders and possesses a noteworthy ethical corporate culture. The board should undoubtedly serve the best interests of the company and its stakeholders and manage potential conflicts of interest. All financial reporting should be based on effective risk-based internal audits and the integrity of the organization should be a given. An effective compliance framework and process must be adhered to. The board of directors could also promote ethical action more by prescribing a formula be used for a CEO that would make his or her share options and even bonus dependent on the attainment of specific courses of action supporting all stakeholders as well as the obtaining of both short and long term objectives and leading to value creation (Huse, 2007). A problem in this approach is that a board may consider some happenings to be beyond the scope of the CEO’s jurisdiction and so this could cause problems as the CEO would still be awarded share options. Furthermore, it is not really clear if share options are indeed motivators for CEOs and directors to seek the good for all stakeholders in an organization. Where there are extremes of economic inequality, there is bound to be social upheaval. Generally, excessive executive remuneration is not justifiable and CEOs and directors need to be held far more accountable than is currently the case. Unrestricted pay and share options policies should be rejected outright on the basis of distributive justice. Remuneration packages should be proportionate and no CEO or director should receive more than 75 times more salary than an employee at the lowest level in an organization and even then, there should be very strong grounds for such a ratio to exist at all. When there is culpable failure in an organization the executives should be held totally accountable (Higginson & Clough, 2010). Where there are inordinate payouts to CEOs and directors and often mid-level managers, these should be subject to exigent performance criteria reflecting the objectives and performance relative to all the stakeholders of the organization, and social justice must prevail. This is not to say that shareholders should not also benefit. The different functions, structures and processes of corporate governance that exist in organizations, imply that there is indeed a necessity to draw on an assortment of theoretical viewpoints beyond the customary agency theory approach.

Before principals and boards of directors consider share options as compensation plans, they should select appropriate metrics and direct the plans so they align themselves with long-term shareholder and stakeholder value creation. They will also need to scrutinize cash flow, the real return on investment and cash value added to the company before approving share option payouts. If CEOs are to be offered share options these need to be gradually phased in based on excellent organizational performance and they should be essentially be part of a long-term incentive scheme and not discounted. CEOs should also not be
able to cash shares in under a period of at least 4-5 years.

There should be transparent and simple models of executive remuneration that will make the facilitation of accountability a lot easier. While share options are widely used attraction and retention incentives, they should be carefully considered before implementation and all financial statements should be carefully analysed before a CEO is paid out. Share options are also highly controversial as there should undoubtedly also be more concern for the pay meted out to workers in general and to the uplifting of all stakeholders where possible. CEOs should not be appointed who are likely to put their own interests above those of the stakeholders in general, and who are at variance with the principals who appoint them. Clearly, share option plans do not always have the desired effect of motivating employees with a personal stake in the accomplishments of an organization. There are cases where the offering of share options is seen as simply an attempt by an organization to fulfill BBBEE requirements and obligations and it is otherwise a façade. Share options are ineffective tools and financial instruments if they are not carefully controlled and simply handed out indiscriminately without links to any kind of benchmark. Share option grants should in any event, be linked to the relative and not absolute, performance of an organization.

Business Ethics is undoubtedly an important aspect which ensures that an organization becomes successful (Arjoon, 2005). Consequently, ethical codes of conduct should assume a major role in an organizations policy formulation (Fleege and Adrian, 2004). Code of ethics are essential in supporting the control of inter-alia employee behaviour clarify the objectives that an organization pursues, and expounds on its norms and values and upholds the things for which it should be accountable and they also to an extent legitimate a trustworthy public image and prevent public criticism (Stevens, 1994). South Africa requires sufficiently educated and competent directors and where there are currently ill-equipped CEOs in positions beyond their levels of competence, training should be available. In addition the culture of self-preservation that pervades the upper echelons of many organizations needs to be stamped out as this greed and self-seeking interest is the breeding ground of corruption which immediately inhibits growth and international investment thus inhibiting growth. Where CEOs are corrupt stakeholders and shareholders suffer immensely so risk management must be used as a process that utilizes internal controls as a measure to utilize diminish and manage risk.

The Code of Ethics is one tool which will spell out how and why an organization lays emphasis on its responsibilities towards society in general. It should spell out that an organization is obliged to be committed to managers who take interest in the welfare of society as well as their own interest. Apart from being a moral obligation, it makes economic sense as part of a company’s life cycle (Jawahar & McLaughlin, 2001) to support all stakeholders since it is more cost efficient to deal with social issues before they consume a large portion of management’s time and money (Jones, 1995). The implications of what this article states about effective corporate governance and the effective managing of share options plans, for example, makes it clear that it is time to leverage the opportunities presented in South Africa since the King Reports. It is time to allow fundamental transformation to rule or let go of a chance to make South Africa economically stable and safe and corruption free to a greater extent. Share options are but one tool to motivate employees and other means of motivating and incentivizing employees should be considered. A trustworthy, moral and ethical environment will be the magnet which attracts foreign investors to help us develop
the rich natural endowment of South Africa, to the betterment of all stakeholders.

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