Stock-take of the Implementation of Performance-Linked Compensation ("PLC") in Government-Linked Companies ("GLCs")

Interim Report
29 July 2005

1. BACKGROUND

In May 2004, the Ministry of Finance issued guidelines entitled 'Implementation of Performance-Linked Compensation ("PLC") in Government Linked Companies ("GLCs")', also commonly referred to as the 'Blue Book', which introduced the usage of Key Performance Indicators (KPIs) and PLC. In January 2005, The Putrajaya Committee on GLC High Performance (PCG) was established to catalyse the transformation of GLCs by following through on the Blue Book and other 2004 initiatives[1] and launching a series of initiatives in 2005/06.

Having crossed the one year milestone since the release of the Blue Book, it is timely to assess the progress of the KPIs/PLC implementations to date. With this objective in mind, the stock-take was launched to develop an understanding of the PLC implementation and harness 'on the ground' experiences to strengthen the Guidelines further. The Guidelines that follow incorporate the collective experiences and learnings from the implementation at the G-15.[2]

The scope of the stock-take does not cover a detailed audit of the KPIs/PLC implementation. The goal was to obtain a high level understanding by studying the process rather than the details. For example, we would identify whether there was a process to ensure KPI alignment to strategy rather than understanding the strategy of the respective companies and linking it back to their respective KPIs.

The stock-take at present is still on-going and therefore the findings are preliminary, but minimal change is anticipated. The first round of interviews with management and analyses has been completed.

2. METHODOLOGY

The stock-take has been conducted over a one month period with over 40 perspectives sought from the G-15. Focused interviews are carried out with the following target groups:
- o Board of Directors
- o CEOs and senior management from Corporate Planning & Strategy, Human Resource, Finance
- o External consultants

The purpose of the interviews is to obtain various perspectives from management and external parties to form a holistic picture of the state of PLC implementation at the G-

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[1] Announced in the Keynote Address by YAB Dato' Seri Abdullah Haji Ahmad Badawi, Prime Minister and Minister of Finance, at the Seminar on Culture of High Performance for GLCs, dated 14 May 2004

[2] The "G-15" is a selection of 15 GLCs held by the GLIC constituents of the PCG and represent approximately 65% of market capitalisation of all listed GLCs

15. The findings from these interviews are further supported by desktop reviews of key documentation on KPIs/PLC, employment contracts and processes.

Scoring

The assessment was carried out along two main criteria: compliance to the Blue Book (the "Form") and effectiveness of implementation (the "Substance"). Using the scores from the assessment, each of the G-15 was then rated on a 5-point scale of Strong, Good, Moderate, Weak and Poor.

The compliance assessment evaluates whether the G-15 have complied with the elements prescribed in the Blue Book[3]. Factors used to measure compliance include CEO and senior management on contract, existence of formal corporate strategy, KPIs implemented and cascaded, base pay benchmarked, and formal performance management process in place.

The effectiveness scale measures the quality of the implementation and whether the KPIs and PLC support long term performance transformation (within the context of high-level interviews rather than detailed audits).

Factors used to measure effectiveness include active Board involvement in KPI design and review, timely achievement against targets discussions at monthly management meetings, active management of strategy and linking it to KPIs, clear programme to manage talent, and transparent link between performance and rewards or consequence management.

3. KEY FINDINGS

Most G-15 have implemented some form of KPI/PLC in compliance with the Blue Book. However, the effectiveness of the implementations differs greatly across the G-15 with many companies not as yet enjoying the full impact of the program. Figure 1 provides an overview of the stock-take findings across the G-15.

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[3] Elements of the Blue Book: eligibility, KPI design, performance monitoring and review, base pay and performance bonus.

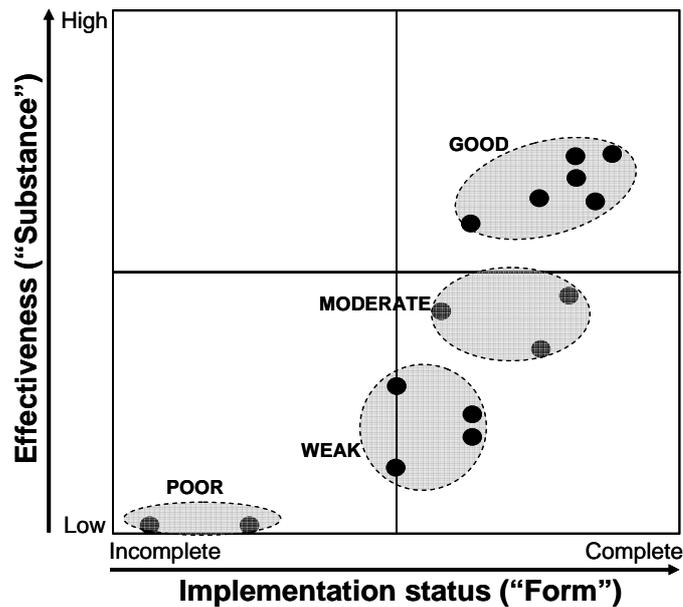**G15 Compliance-Effectiveness Grid**

Figure 1: G15 Compliance-Effectiveness Grid

The stock-take findings are structured around five key categories of KPIs/PLC implementation – eligibility, KPI design, performance monitoring and review, base pay and performance bonus. The findings have been aggregated across the G-15

Category	Guidelines	Key findings
Eligibility	• CEO and 2-3 levels down to go on contract • KPIs/PLC implemented and cascaded to all executives	Compliance - Moderate • Most CEOs on fixed term contracts • Approximately half of direct reports to CEO on contracts • Most G-15 have cascaded KPIs to executives Effectiveness - Weak • Communications with management 2-3 levels below CEO and incentives programme was insufficient to convince them to move to fixed term employment contracts • Contract lacks specific terms on performance and reward

Category	Guidelines	Key findings
KPI Design	• Aligned to strategy • Balanced • Stretched and benchmarked targets • Focused KPIs (5-8)	Compliance - Moderate • Most companies do not have formal strategy • Most companies have 5-8 KPIs • Most companies obtain Board endorsement of their KPIs Effectiveness - Weak • KPIs not strongly driven by strategy as evidenced by lack of KPI alignment process • KPIs are used more of a 'HR tool' rather than a strategy execution tool, with KPI development process being driven by HR unit, not Corporate Strategy • KPIs financially skewed and not balanced • Low incidence of benchmarking resulting in targets not stretched and poorly supported when challenged • Significant skill gaps for the KPIs/PLC implementation within the organisation • Low incidence of G-15 using 'corporate scorecards' (i.e. regular monitoring of important value drivers that are not part of CEO's KPIs) to manage business • Relative lack of Board engagement in KPI development

Category	Guidelines	Key findings
Performance Monitoring and Review	• Regular review of business and individual performance • Systematic process of setting, monitoring and reviewing targets at divisional, management committee and Board levels • Process to derive and track action points from the review	Compliance - Moderate • Most companies have a regular performance appraisal process • Few review KPIs in monthly management committee meetings • Few have quarterly Board reviews for business KPIs Effectiveness - Weak • Board and middle management are not adequately engaged in KPIs review • Insufficient spread of performance scores • Poor consequence management processes, both for high and low performers • Approximately half are able to accurately measure KPIs on a timely[4] basis every month • Poor internal infrastructure[5] • No formal interim review of KPIs with detailed action points for the second half of the year

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[4] Timely measurement of KPIs would differ between industries, but the rule of thumb used here is no more than 15 days

[5] Infrastructure is defined as processes, systems, organisation structure, board governance

Category	Guidelines	Key findings
Base Pay	• Market competitive, benchmarked at market median within similar industry, size, customer base	Compliance – Good • Most companies benchmark base pay using data from surveys conducted by HR consultants • Few benchmark their cash compensation at market median and above Effectiveness - Weak • Most companies find it difficult to attract and retain the desired talent • Approximately half have a link between increments and performance
Performance Bonus	• Minimum threshold • Transparent and directly linked to performance • Mix of short and long term incentives	Compliance - Good • Approximately half have bonuses which are directly linked to individual performance • Non banking G-15 commonly use a fixed to variable compensation ratio of 70:30 • In some G-15, Board does not have full discretion in approving bonuses Effectiveness - Moderate • Resistance to differentiated rewards, most do not significantly differentiate high and low performers

4. CONCLUSIONS

Generally, G-15 have made significant progress in implementing the Blue Book - many have already complied with most of the Guiding Principles. However, the stock-take has found that the effectiveness in implementation could be significantly improved to move beyond the form to substance.

The key issues uncovered above can be summarised as the following:
- o Lack of focus on business priorities by not tightly linking KPIs to strategy
- o Talent management is poor across G-15, specifically in the areas of attracting top talent, differentiating between individual performance, managing rewards and consequences

- KPIs and targets are sometimes not objective and balanced, frequently not fact-based
- Poor engagement and skills gap at the middle management to effectively cascade the KPIs throughout the organisation
- Lack of communication from the leadership and show of commitment to KPI implementation process

Looking forward, Blue Book version 2 will be an attempt at addressing these issues, and provide clarifying examples to guide the implementation.