IMPLEMENTATION OF PERFORMANCE-LINKED COMPENSATION ("PLC") IN GOVERNMENT-LINKED COMPANIES ("GLCs")

GUIDING PRINCIPLES

PLC Steering Committee
Ministry of Finance

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INTRODUCTION

In the context of reinventing Malaysia Inc, the Government has introduced a set of initiatives towards promoting a culture of high performance in Government Linked Corporations (GLCs). A key initiative is the implementation of Key Performance Indicators (KPIs) and the introduction of Performance-Linked Compensation (PLC) for all GLCs.

The objectives of implementing KPIs and PLC are to:

- Ensure focus on key business priorities
- Attract and retain outstanding professional talent
- Enable performance to be measured objectively
- Motivate employees by linking rewards to performance

The purpose is to drive GLCs towards higher performance and global competitiveness, with just rewards for GLC employees. The ultimate objective is to enable GLCs to lead the private sector, as the engine for long term sustainable economic growth.

ABOUT THE GUIDELINES

This document provides general guidelines to assist GLCs in their effort to implement KPIs and PLC. All GLCs are encouraged to adhere to the Guidelines. Any material departures from the Guidelines must be cleared with the PLC Steering Committee.

FOUR CATEGORIES OF GUIDELINES

The Guidelines fall under four areas, namely:

1. KPI Design
2. Base Pay
3. Performance Bonus
4. Eligibility

(1) KPI DESIGN

All GLCs should introduce rigorous KPIs to measure management performance. The KPIs must be based on a balanced set of objective measures, benchmarked against the industry, cascaded to individual senior managers and reviewed regularly.

The guidelines for KPI Design are as follows:

Guideline	Description
1.1 Balanced and holistic set of KPIs	• KPIs must represent stretched targets and be derived from the corporate vision, mission and business plans, geared towards taking the GLCs to the next level of performance and competitiveness. • KPIs should be balanced and holistic reflecting priorities in key dimensions including financial, customer, organisation and operations. • KPIs selected should be actionable and measurable. Subjectivity must be avoided or reduced. Where the KPI is linked to a process, for example, completion of financial restructuring, clear targets should be set to measure progress and desired outcome. Indices and surveys may be used to quantify subjective measures.
1.2 Targets to be bench-marked against the industry	• The performance of GLCs must be bench-marked against other industry peers, both domestically and where applicable, internationally. • Targets for each KPI must be set such that the GLCs' performance vis-ą-vis comparator companies is enhanced.
1.3 Individual KPI scorecards for senior management	• In order to ensure clarity and focus, the number of KPIs need to be set at an appropriate level. Best practice suggests this to be between five and eight KPIs per executive with a maximum of ten. • KPIs must be appropriately weighted based on their importance to the business objectives and the individual's control over the KPIs.

Guideline	Description
	• KPIs for employees other than senior management should be derived through a cascading-down process.
1.4 Targets to be set annually and reviewed by the Board	• A systematic KPI development, target-setting, monitoring and review process should be put in place. • Board should regularly review actual results against KPI targets, for example, on a quarterly basis, identify issues and recommend remedial action.

(2) BASE PAY

The Government is supportive of GLCs undertaking appropriate compensation review to attract and retain the right talent, while balancing affordability considerations.

The guideline for setting senior management base pay is as follows:

Guideline	Description
2.1 Base pay should be market competitive	• Executives' base pay should be set at about the market average, based on a suitable basket of comparator companies. • Comparator companies are, where applicable, those companies operating in the same industry, of approximately the same size (for example measured by revenue, customer base, number of employees), and subject to similar complexity and risk.

(3) PERFORMANCE BONUS

GLCs may use cash, shares or a combination of both as pay-outs for performance bonus to align the behaviours of employees with the goals and business plan – both short term and long term. Performance bonus must be directly linked to employees' performance, whilst being financially sustainable at the same time.

The guidelines for performance bonus are as follows:

Guideline	Description
3.1 Minimum threshold before qualifying for performance bonus	• There should be a minimum performance threshold measured against the KPIs, that has to be met before entitling the employee to the performance bonus. • The minimum threshold should be set by the Board. However, the threshold should not be less that 50%.
3.2 Payout to be directly linked to KPI score	• Once the minimum threshold has been met or exceeded, there should be a correlation between the executive's KPI score and the performance bonus pay-out. For example, if the employee achieves 90% of his KPI target, the executive may be entitled to receive 80% of the performance bonus. • Board reserves the right to determine the final performance bonus payout.

Guideline	Description
3.3 Performance bonus to be market competitive	• The performance bonus element should be competitive to recognise the targets achieved. The total compensation may match or exceed the market average if justified. • Respective Boards should set their companies' performance bonuses commensurate with the company's performance and competition for talent.
3.4 Use of cash rewards	• Cash or combination of cash and shares may be used to align short term incentives. • GLCs' ability to afford a cash payout must be built into the reward calculation.Performance bonus should be self-funded by additional profits arising out of superior company performance. For example, based on quarterly performance of the GLC, a certain "cash pool" is accrued for the performance bonus payout. The individual's performance bonus is then a percentage applied to the amount in the cash pool.
3.5 Use of shares	• Long term incentives should principally be aligned using shares (share options, share appreciation rights or other forms of share-based instruments), where GLCs are in position to do so. • Measures should be in place to discourage short-term focus. For example, the number of shares awarded should be spread over, for example, a five year vesting period. Option price offered should be based on market price on the date of award without any discount as the intention is for the share price to appreciate with improved performance.

(4) ELIGIBILITY

The guidelines under this category govern the group of employees that may or may not partake in the PLC scheme, and how they would be impacted.

The guidelines for eligibility are as follows:

Guideline	Description
4.1 Senior Management should participate in new KPI-PLC scheme	• Senior Management (typically defined as CEO and two to three levels below), should participate in the PLC scheme. • Where appropriate, they should be offered employment contracts with explicit performance bonuses linked to KPIs and defined termination clauses and costs. • At the end of contract period or in the event of position vacancy, there should be open competition for senior management posts. Executive search firms may be used to locate external talent. Internal and external talent should be benchmarked.
4.2 Other Employees should also be subject to principles of PLC	• The principles of linking rewards with performance should be applied to all levels of the organisation, through ESOS schemes, cash bonuses and promotions. • However, certain elements of the KPI-PLC scheme applied to senior management may not be applicable to other employees e.g. employment contract .
4.3 Non-Executive Directors are not eligible	• Non-Executive Directors are not eligible to participate in incentive schemes, due to the need to maintain appropriate check and balance.

IMPLEMENTATION TIMELINE AND PROGRESS REPORTING

GLCs are expected to commence the PLC design immediately to enable its implementation no later than 1st January 2005. For GLCs whose next year end is on or after 30th September 2004, the implementation should commence after the end of the 2004 financial year.

Where appropriate, GLCs should make use of findings and recommendations from past KPI initiatives, and develop the link to compensation. Effective implementation of PLC will require coordination between business plan/budget setting with financial and operational reporting, and employee assessment/ appraisals.

GLCs should set up a Project Steering Committee for the implementation of PLC, which would report to the Board or Board Remuneration Committee.

The Government's PLC Steering Committee will assess the progress of implementation at each GLC.

GLOSSARY

GLCs : Government Linked Companies
KPI : Key Performance Indicator
PLC : Performance-Linked Compensation
Board : Board of Directors