Research on the Executive Performance Evaluation Model of Large Energy Enterprises

Jian Zhao¹, Lei Huang²

¹State Grid Energy Research Institute Co., Ltd, Beijing 102209, China
²Professional Qualification Authority of Ministry of Transport, Beijing 100029, China
zhaojian@sgeri.sgcc.com.cn

Abstract. Accurate performance evaluation and scientific compensation structure are significant to solve the dilemma of corporate governance principal-agent and realize the long-term benefit sharing between executives and shareholders. This paper takes BP as the research object, analysing performance evaluation model and compensation structure of BP’s executive. The performance evaluation model has six factors which are safety, reliable operations, financial performance, total shareholder return, return on average capital employed, and strategic priorities. Indicators, weights and evaluation criteria of performance evaluation are constructed in the model. Algorithm for computing compensation structure is also provided.

1. Instruction
British Petroleum (BP) is one of the world's largest oil and petrochemical groups. Its main businesses include oil and gas exploration and development, natural gas sales, power generation, oil retail and transportation, petrochemical production and sales etc. BP has operations in more than 70 countries and regions around the world and employs 74,000 people worldwide. In May 2010, BP experienced a US Gulf of Mexico oil spill. Bob Dudley is on the verge of becoming the new CEO. However, due to the impact of international oil prices, after Bob Dudley took office, BP's operating performance was not satisfactory, and the CEO's compensation policy gradually became the focus of contradictions. In 2015, BP lost $5.2 billion, while according to the original compensation policy, Bob Dudley's annual total compensation will still be raised, and the compensation plan was voted against by 59% of shareholders. In order to protect the interests of shareholders and achieve long-term sharing of interests between shareholders and shareholders, BP adjusted the executive compensation policy in 2017. This paper systematically analyzes BP's executive compensation policy and provides reference for the design of executive compensation policies of other large energy companies.

2. Compensation structure and performance evaluation model

2.1. Remuneration Committee Exercises Executive Compensation Management Functions
The Remuneration Committee is a special committee established by the Board of Directors. It does not participate in the operation and management. Its main responsibility is to formulate compensation plans for the company's senior management and supervise the implementation of the compensation plan.

BP's compensation committee consists of six independent non-executive directors. All members of the Remuneration Committee are well-known executives and consultants in the industry. They are the Vice President of the University of Cambridge, the former chairman of Fluor, the former chairman of...
McKinsey, the former CEO of KPMG, and the former CEO of Safeco Insurance. Some members of compensation committee also serve as BP nomination committees, the audit committee and other positions. The remuneration committee composed of independent directors not only ensures the objectivity and rationality of executive compensation design to a certain extent, but also reduces insider control and effectively represents and protects the interests of shareholders.

The responsibilities of the remuneration committee can be summarized into four aspects. One is to formulate the remuneration plan of BP executives (including CEO and CFO) and submit it to the board of directors and shareholders meeting for discussion and approval. The remuneration plan includes salary structure, salary level, payment methods and welfare such as pension, allowance and supplementary insurance. The second is to regularly evaluate the performance of BP executives and calculate the salary, set the performance goals that match the company's strategy for the executives, regularly evaluate the performance of the executives, and calculate the actual compensation that the company should pay to the executives according to the performance. The third is to fulfill the executive compensation function, including the disclosure of executive compensation to shareholders and the public, and the implementation of the executive compensation recovery policy. The fourth is to review the CEO's remuneration policy when paying for other senior management of the group.

2.2. Compensation Structure Focuses on Performance-Oriented and Deferred Payment

The salary of BP executives is divided into two parts: fixed salary and variable salary. Fixed salary is not affected by the performance of companies and executives. It consists of Salary and benefits and Retirement benefits. Variable salary will be adjusted according to the performance of the company and senior executives. It consists of Annual bonus, Performance shares and Shareholding requirements. As figure 1 shows, variable salary accounts for more than half of the total salary.

![Figure 1. Executive compensation composition.](image)

The basic salary in fixed salary is determined by the remuneration committee. The remuneration committee reviews the basic salary of the executives according to the senior management's job responsibilities, corporate performance, executive performance, and salary market benchmarking. Benefits consist of two parts: One is the benefits enjoyed by all employees of the company, including sick pay, relocation allowance, maternity allowance, profit sharing plan, etc. The other part is the exclusive benefits of senior executives, including transportation subsidies, providing drivers and security, extra medical and other insurance.

The three components of variable compensation correspond to the company's short-term, medium-term and long-term development goals. The Annual bonus is determined by the performance target formulated at the beginning of the year and the performance result completed at the end of the year. The compensation committee will evaluate the company's annual performance from three aspects of finance, operation and safety, and decide the annual bonus based on the evaluation result. 50% of the annual bonus is paid in cash, the remaining 50% is paid in stock, and the stock holding is mandatory for 3 years. When performance exceeds the target, executives can receive up to 2.25 times the base salary (including deferred payments). The purpose of performance shares is to tie executive compensation to the long-term development of the company's business. Every three years, the compensation committee will be executives from three aspects: the company's shareholder return rate, average return on capital and strategic progress. Performance share is paid in the form of stocks and is mandatory to hold stocks for 3 years. The CEO can get a performance share of up to 5 times the basic salary. The CFO can get up to
4.5 times the basic salary. Each executive will receive equity no less than five times its base salary during his or her term, and the executive will be eligible to exercise this share after retirement.

2.3. Performance compensation is determined by the company's strategy implementation

Scientifically and rationally break down the company's strategic goals. Each year, BP sets the strategic goals based on the company's development plan. Taking 2017 as an example, BP clearly stated the “Growing sustainable free cash flow and distributions to shareholders over the long term” as the company's overall strategic goal, and decomposed into three specific sub-goals: Safer, Fit for future and Focused on returns. At the beginning of each year, the Remuneration Committee further decomposes the strategic objectives and forms quantifiable performance influencing factors. The assessment results will directly affect the annual bonus and performance shares of the executive compensation structure. Table 1 shows the relationship between compensation and performance factors and corporate strategy.

| Element of Remuneration | Performance Factors and Weight | Strategic Goal Decomposition |
|-------------------------|--------------------------------|-----------------------------|
|                         | Safer related                  | Fit for Future related      |
|                         | Financial performance related  | Focused on Returns related  |

Establish quantitative evaluation criteria for key performance indicators. At the beginning of each year, the Remuneration Committee updates the assessment criteria and weights, and communicates with the executives to agree on the evaluation criteria for each key performance indicator as the basis for the performance evaluation. At the end of the year, the Compensation Committee will assign a score to each performance indicator based on the company's actual performance, thereby calculating the assessment results of the executive's annual bonus and performance shares. Table 2 and Table 3 shows the evaluation criteria and assessment results of 2017 BP executives' annual bonuses and performance shares.

| Factors | Indicators and Weights | Evaluation Criteria of Performance | Outcome |
|---------|------------------------|-----------------------------------|---------|
| Safety  | Tier 1 process safety event (10%) | Criteria Score 24 events | 18 events |
|         | Recordable injury frequency (10%) | Criteria Score 0.25 | 0.13 |
| Reliable operations (30%) | Downstream refining availability (15%) | Criteria Score 0.96 | 0.95 |
|         | Upstream operating efficiency (15%) | Criteria Score 0.77 | 0.95 |
| Financial performance (50%) | Operating cash flow (20%) | Criteria Score $19.9bn | $24.1bn |
|         | Underlying replacement cost profit (20%) | Criteria Score $5.0bn | $6.2bn |
|         | Upstream unit production costs (20%) | Criteria Score $7.7/bbl | $7.11/bbl |
| Formulaic score | | | 1.54/2 |

| Factors | Indicators | Evaluation Criteria of Performance | Performance |
|---------|------------|-----------------------------------|-------------|
| Financial | Relative total shareholder return | Threshold performance | Maximum performance | Weighting at maximum | Outcome | Score |
|         | Cumulative operating cash flow | $45.6% | $61.6% | 33.3% | First | $61.9bn | 33.3% |
| Strategic imperatives | Relative reserves replacement ratio | Third | First | 11.1% | Second | 8.9% |
|         | Major project delivery | 10 | 14 | 11.1% | 17 | 11.1% |
|         | Safety an operational risk | Continuous improvement look back | 11.1% | 85% of maximum | 9.4% |
The company's performance directly affects the overall salary level of BP executives. Fixed compensation is not affected by performance, while annual bonuses and performance shares are closely related to performance. If the minimum performance target can be achieved, the executives are unable to obtain the annual award and performance shares, while only if the maximum target can be achieved, all executives can receive award of 2.25 times their base salary. In addition, the CEO can get performance shares 5 times of his basic salary, and the CFO can get performance shares 4.5 times of his basic salary.

3. Conclusion
The incentive of executives should reflect strategic orientation, highlight quantitative evaluation, and focus on long-term results. BP's executive compensation management is unique. First, BP has decomposed strategic objectives into quantitative performance appraisal standards in accordance with the “Strategic Goal, Performance Factors, and Performance Indicators”. Second, BP focus on establishing a value evaluation system based on facts and data. By clarifying the assessment criteria and quantifying the performance, the performance evaluation of senior executives is fair and open, laying a solid foundation for the subsequent value distribution. Third, highly focused on the application of assessment results, the performance of executives is directly linked to their compensation packages, of which variable compensation accounts for more than half of the total compensation. Finally, focus on the long-term effects of incentives and constraints. In terms of target setting, BP requires both the senior management to focus on the key tasks of the year and the strategic orientation of long-term development. In terms of incentives, cash and equity are used both in order to focus on the medium and long-term incentives of executives.

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