Post #40: The BP Shareholder Vote: A Cautionary Tale

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Compensation is often more about the message than the money. BP's recent shareholder vote offered some valuable lessons for other energy companies about sending the right messages to shareholders when commodity prices impact business results.

On April 14th, nearly 60% of voting BP shareholders opposed BP's compensation programs. The press reported that shareholders were upset about CEO Bob Dudley's 20% increase in total remuneration, including pension, amid falling profits and job losses at the oil major.

Informed readers would spot quickly that the large majority of the reported pay increase came from 2015 pension accruals, which were basically unrelated to the board's evaluation of company or CEO performance.

The real issue for BP was that its metric-based annual bonus program yielded near-maximum scores for performance against a dramatically reduced 2015 budget.

	2015		2014		Change in Actual
Select BP Bonus Plan Financial Metrics	Target	Actual	Target	Actual	
Operating Cash Flow (Bln)	\$17.20	\$19.70	\$30.00	\$32.80	-39.9%
Underlying replacement cost profit (Bln)	\$4.20	\$5.00	\$14.50	\$12.10	-58.7%

A nearly 40% drop in operating cash flow yielded a score of 180% of target performance, and a nearly 60% decrease in replacement cost profit maxed out at 200% of target. Nearly all the other operating and financial metrics likewise maxed out at 200% target.

In 2015 BP recorded a \$6.5 billion loss attributable to shareholders, and the company's total shareholder return (stock price change plus dividends) was -12.6%. BP also reportedly laid off about 4,000 employees in 2015, and announced plans to lay off 4,000 more in 2016.

In many respects, BP ran its bonus program exactly the way it was "supposed to", based on prevailing governance norms. The BP board set objective, formulaic goals for metrics reasonably aligned to long-term shareholder value. They held the company accountable to performance against those goals. Perhaps they overestimated the negative impact of commodity price declines, but it's reasonable to assume that BP applied a rigorous budgeting and planning process in a period with many uncertainties.

BP's board faced the same challenge that many energy companies have faced: how to reconcile above-target performance against "budget" in a period when shareholders lose on both the stock price and the bottom line. Meridian has observed that many energy boards managed their final bonus outcomes downward to acknowledge how shareholders would feel about the payments. Most energy companies indeed paid bonuses despite poor financial results, but at levels that conveyed an understanding that shareholders have generally not done well.

At BP, the Board adjusted the bonus score downward, but only to 170% of target. The Board also reinforced the underlying conclusion that the company performed exceptionally well in 2015: "BP had an excellent year for safety and operational performance in a difficult environment."

The public didn't buy the message. The Financial Times wrote: "Boards of directors are not appointed to rubber-stamp formulas devised by consultants, no matter what the result." A majority of voting shareholders appeared to have a similar view.

In this case, it appears that BP's adherence to "the process" will end up costing them – perhaps a lot more than the incremental compensation paid.

- The rare voting rebuke creates a setback to the admirable progress BP has made restoring its public reputation since the Gulf of Mexico oil spill.
- BP will spend even more time and money on shareholder engagement, and the public relations effort to regain credibility.
- The adverse publicity likely makes BP employees feel as if their bonuses came at the unfair expense of shareholders or their former colleagues, rather than as recognition for good performance.

It's hard to say whether a lower bonus would have yielded a different outcome. The experience does reinforce the importance of board judgment and discretion in crafting the right message, especially if the formulas don't seem to tell the complete story.