TRENDS IN DUTCH EXECUTIVE COMPENSATION

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This article describes the trends in Dutch executive pay contracts. To increase our insight into this subject area, we conducted an empirical study on the basis of remuneration data provided by the executive board members of 71 Dutch listed companies over the period 2002-2004. The study starts from the premise that the characteristics of a unique corporate governance regime, together with the environmental context, shape compensation arrangements. Based on a theoretical research study, which combines our empirical research results with a literature overview, we argue that an optimal compensation arrangement is a trade-off among complying with corporate governance standards, optimizing potential incentives, preventing perverse incentives and offering a competitive pay package. It appears that this trade-off differs with each company at any moment in time. The relevance of this study may be threefold. First, its results can help shape the public debate about the pay of top executives in the Netherlands. Second, it could serve as a blueprint for future research on executive compensation in the specific context of the Dutch governance system. Furthermore, it could help remuneration committees in designing optimal compensation packages.

1. INTRODUCTION

One could regard the Dutch corporate governance system as a combination of the Anglo-Saxon and Continental-European governance systems[2]. A study of how executive compensation practices have evolved in such a landscape is therefore an interesting one. Since a couple of years now, Dutch executive compensation and corporate governance practices have been the subject of a

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[2] See: http://www.vlerick.com/en/5786-VLK/version/live/part/AttachmentData/data/vlgms-wp-2001-06

heated debate. Large share price increases and subsequent option gains in the late ’90s led former Dutch prime-minister Wim Kok, as one of the first, to openly agitate against the ‘exhibitionistic self-enrichment’ of top executives. Since then, in 2002, the disclosure of the remuneration data of all individual members of the executive board was made compulsory; each year around springtime, when excessive amounts of compensation are revealed, a carnival of social outrage and debate breaks out.

In addition, as a result of the accounting scandals at the beginning of the 21st century, the Dutch corporate governance environment has profoundly changed. The prime exponent of this changing corporate governance environment was the implementation of the Dutch Corporate Governance Code in 2003, more commonly referred to as the Tabaksblat Code[3]. The combination of a unique governance system and a rapidly changing business environment makes Dutch executive compensation an interesting topic for research. This research could shed light on the influence of the public pressure on and political interference in compensation practices in an environment of increasing shareholder pressure, in which shareholder value creation has become the prime measure of business success.

2. SCOPE AND BACKGROUND

Typical of the Dutch corporate governance regime is its two-tier board structure in which the executive board (‘Raad van Bestuur’) is responsible for the daily operations of the firm and the supervisory board (‘Raad van Commissarissen’) carries out the tasks of appointing, monitoring, suspending and dismissing (if necessary) the members of the executive board as well as assessing and ratifying major business decisions. The members of the supervisory board are appointed by co-optation for a four-year term (Van Ees et al., 2003). Under the influence of a number of Anglo-Dutch companies and the increase in Anglo-Saxon shareholdings, one can observe a slow shift in preference for the Anglo-Saxon unitary board structure.

In the past, this system could be characterized by a large degree of protectionism and managerial entrenchment. By issuing preference shares, tradable depository receipts and priority shares with limited voting rights as well as installing administration offices, ownership was effectively separated from control, thereby ensuring take-over defences in the case of a hostile take-over bid. This has led to an investor-unfriendly governance climate, the so-

[3] Named after Morris Tabaksblat, who chaired the committee, which consisted of several representatives of different stakeholder groups.
(See: http://www.commissiecorporategovernance.nl).

called 'Dutch discount' on all Dutch share prices[4]. Until a couple of years ago, a market for corporate control hardly existed and the Annual Meeting of Shareholders only had a limited influence. The co-optation principle and the large influence of the executive board on the appointments of the supervisory board have furthermore led to a high degree of managerial entrenchment (Van Ees and Postma, 2004). The popular media have often referred to this phenomenon as the 'old boys network', in which the small business community in the Netherlands has divided all 'sideline-jobs'[5] among one another[6]. In this context, the large increases in executive pay have also been considered as a favour among friends.

In the last two decades, however, a series of economic, technical and societal developments have significantly changed the governance structures in the Netherlands. First, the increasing globalization of the business environment has changed the Dutch corporate structures. Internationally oriented for some time now, Dutch companies have made a new series of acquisitions in many parts of the world, making the current business processes even more globally dispersed. In 2004, on average 58% of the turnover of the largest listed companies and 71% of that of the 25 AEX companies were realized abroad. On top of this, an increasing number of business functions and processes have been outsourced or transferred to low-cost countries. The increasing competitiveness on a global level has had a quick impact on businesses that underperform, which has stimulated discipline in the product markets.

The labor market for executives has also internationalized rapidly. The percentage of foreign CEOs at AEX companies doubled in only two years from 24% in 2002 to 48% in 2004[7]. These CEOs all bring different attitudes to the boardroom, which subsequently have an impact on the corporate governance standards. These attitudes involve, for example, issues such as the role of shareholders, the role of the supervisory board and executive remuneration. The globalization of the managerial labour market has increased competitiveness and made it more dynamic.

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[4] Because of these take-over barriers Dutch shares were traded with discounts of up to 20% in comparison with the shares of foreign peers.
[5] Ironically, for a long time these directors merely considered supervisory board membership as a sideline-job, with only limited responsibilities, while having an almost unlimited trust in the capabilities of the executive directors.
[6] See: http://www.elite-research.org/man1.html?/topmanagers.html
[7] See: http://www.mb.utwente.nl/oohr/events/past/HRMfirst/presentations/keynote.pps

3. CONCEPTS AND METHODS

The main objective of this paper is to present the real facts on executive compensation in the Netherlands. Our empirical study has focused on the remuneration practices of 71 Dutch listed companies. Since 2002, all Dutch companies that are listed have been required to disclose the remuneration figures of the individual members of the executive board in their annual accounts. The number of companies that are listed on the Dutch Stock Exchange ('Euronext Amsterdam') is, however, rather limited (approximately 150 companies) and the differences in firm size among these companies are considerable. Therefore, since remuneration practices are only reasonably developed at large companies, the relevance of the results and the comparability with other studies[8] would decrease if all small companies were included. This is why we made a selection of the most prominent and largest companies, which has resulted in 75 enterprises.

Two additional criteria were formulated: 1) the companies should be of Dutch origin or be engaged in substantial managerial activities on the corporate level in the Netherlands[9] and 2) the company may not have been taken-over by another company or be involved in a large restructuring process in the period under review, which has caused to change the position, job and responsibilities of the executives. Two companies were left out because of these requirements. After revision of the data, two more companies were left out because the information they provided was incomplete (base salary and bonus figures).

The remuneration data cover three different years: 2002, 2003 and 2004. In 2002, firms disclosed their individual remuneration data in their annual accounts for the first time. The 2004 data were the most recent available figures at the time of research. In some cases, (qualitative) data on the 2005 remuneration package were taken into account, but only if published in the 2004 annual reports.

The executive board of directors includes three positions: the Chief Executive Officer ('CEO'), Chief Financial Officer ('CFO') and the other members of the executive board. The roles and responsibilities of the other

[8] Most international studies only contain the largest listed companies of the country in question. In the United States most samples are made of S&P 500 companies and in the United Kingdom they mostly consist of FTSE 100 or FTSE 250 companies.
[9] A number of foreign companies use a Dutch listing and holding company primarily for tax purposes, but do not have substantial corporate and operational activities in the Netherlands. Although the principles of the Tabaksblat Code do apply to these companies, it is likely that in these cases the data reflect their remuneration practices in the country where they perform their primary corporate activities.

members of the board are, in general, too diverse to make a representative division and categorization[10]. We only included executive directors in our study. Furthermore, we did not take the remuneration of supervisory board directors (non-executive directors) into account.

The companies forming the population of this study are those that are part of one of the two main stock indices (the AEX Stock Index and the AMX Stock Index ('Midkap'), both consisting of 25 companies and the 25 largest companies ranked by turnover ('Small Caps'), which are not part of one of these indices. Due to the large variations in size and complexity among these companies, we analyzed these subgroups independently. The average turnover of the companies in the population in 2004 was €9.4 billion, the average market value was €5.8 billion, and the average number of employees was 26,861.

4. DATA COLLECTION

Since there are no databases that contain Dutch executive compensation figures, we collected all data from publicly available sources, such as the remuneration sections in the annual accounts of companies. Furthermore, we made use of all other publicly available information, such as the Corporate Governance section on companies' websites, additional remuneration reports, LTI plan regulations, employment contracts, information concerning annual shareholders meetings and SEC filings. We approached a few companies with the request to supply crucial additional information, to which some of them responded positively.

Despite the regulations and prescriptions concerning transparency, as well as the publication of remuneration data, a considerable amount of the data had to be specifically treated in order to make all different company data comparable.

5. RESULTS

The analysis on Dutch remuneration practices resulted in the detection of several trends regarding Dutch executive compensation. Firstly, we found that the principles of the Tabaksblat Code have had a considerable impact on the Dutch remuneration practices. Although not legally binding, companies that do not conform to the majority of the principles are signalled out by the business press, investors or shareholder associations, and can count on heavy criticism in

[10] The other members have responsibilities varying from product division to geographic or functional responsibilities. Their legal status as executive board members is, however, the same (collective responsibility).

publications or at annual shareholder meetings. Thus, in the past few years, this influence had led most companies to review and reconstruct their incentive plans. Secondly, a clear shift from traditional stock option plans to other forms of equity-based pay (performance shares) were found.

A strong increase in the number of companies that have implemented deferred bonus plans was observed. A clear shift from traditional stock option plans to other forms of equity-based pay - in particular, performance shares. During the time this study was conducted, it was expected that in 2005, the percentage of companies that granted performance shares would have risen to 57.8% (from 9.9% in 2002), whereas only 45% of the companies would still grant stock options (from 71.8% in 2002). It can therefore be concluded that there seems to be a clear preference for performance shares. In particular, performance measures such as performance share plans in combination with relative TSR seem to become the new standard in LTI compensation. Finally, we found a rise in equity-based compensation has led to a sharp increase in the value of the executive's total compensation package.

Total compensation of executives augmented to 6.8% in the two-year period 2002-2004, but with a much larger increase in the last year. In particular, the executives of AEX companies saw large increases in their total compensation (28.6% for the CEO). These amounts were the result of increases in all components of the pay package and were, in particular, triggered by increases in the value of equity-based compensation. The equity-based pay package (options and shares) of the CEO rose an astonishing 70.8% in the 2002-2004 period. In the following section, the observed trends and developments will be further outlined.

On the basis of our data, we could identify three major trends and other developments in Dutch executive compensation. In short, the trends relate to revised incentive plans and compensation and to a changed focus on the importance of the supervisory board.

TREND 1: A revision of the incentive plan structures and a renewed focus on the discretionary power of the supervisory board.

One major consequence of the reforms in the incentive plans has been that most performance measures in the incentive plans are now 'previously determined, measurable and influential'[11]. This holds for the performance

[11] The Tabaksblat Code has expressed a clear preference for objective performance measurement. It states specifically that the *'the variable part shall be linked to previously-determined, measurable and influenceable targets'.*

measures in the annual bonus plan as well as for the performance measures that determine the vesting of the long-term incentive grant.

On the other hand, one can observe a trend in which an increasing part of the annual bonus is determined by the discretionary judgment of the supervisory board. In 2004, almost 67% of the companies had adopted individual or qualitative performance measures, which both have a strong discretionary character and, on average, make up 28% of the bonus opportunity. Despite the push for objective performance measurement, supervisory board directors are apparently of the opinion that a discretionary judgment of the performance of the executive board is a valuable measure.

Objective versus subjective performance measurement

The plea for objective performance measurements made by the Tabaksblat Committee is grounded in the belief that the procedures for a bonus setting might not have been fair. By tying the bonus to subjective performance measures, executives can still be compensated even when their performance is poor (Bebchuk and Fried, 2004). The Dutch corporate elite has often been accused of being an 'old boys network', in which personal friendships and business relations influence the supervision function of the supervisory board directors. As a consequence, supervisory board directors might treat befriended executive directors favorably, or they might be influenced by executive board members[12].

Although objective performance evaluation offers the advantage of perceived fairness and visibility, it also has several disadvantages compared to subjective performance evaluation. In many jobs, individual performance cannot be measured and assessed objectively because of joint production or mere 'unobservability'. Furthermore, managers can game the bonus system (e.g. Bebchuk and Fried, 2004; Jensen, 2001), they can be rewarded for luck instead of actual company performance (Bertrand and Mullainathan, 2001) or rewarded or punished for events beyond their control. One can therefore argue that the decision to (partly) reward the executive on a discretionary basis corrects for distorted incentives and helps create a bonus reward that is perceived as more fair and, as a result, better reflects the real performance of the executive.

The decision to adopt a subjective performance measurement can be dependent on several firm-specific factors. For example, Ittner et al. (1997) indicate that when a firm follows an innovation-oriented strategy or when there is a great deal of noise with respect to financial performance measures, the use

[12] As a result the Tabaksblat Committee has also drawn up strict principles concerning the independence of the non-executive directors.

of non-financial measures in bonus plans increases. Bushman et al. (1996) argue that individual performance evaluation increases with the firm's growth opportunities and product time horizon. Ittner et al. (1997) have, however, found no evidence that CEOs with a greater influence on the board of directors are more likely to be compensated on the basis of non-financial performance measures. It is therefore not likely that the rise in subjective performance measurements in Dutch executive contracts is a means to increase the overall compensation of executives. It is more reasonable to suggest that the shift toward more subjective evaluation is rooted in the wish to better award the executive for his or her actual performance.

Consequences of the option plan design

Another result of the Tabaksblat Code is that almost all option grants are now subject to vesting periods and performance conditions and that practically all options are granted at the money. Moreover, concerns often mentioned, such as reissuing (extending the exercise window), retesting (extending the performance period) and re-pricing (discounting the exercise price) are hardly existent anymore[13]. From a corporate governance point of view, this is, in general, considered as a positive development, but on the other hand, it limits the design options of the remuneration committees. They therefore hardly make use of design variations that can bring additional benefits, such as indexed options (Rappaport, 1999), cost of capital options, the possibility of adjusting the exercise price of paid dividends (Jensen and Murphy, 2004) or granting at a discount (Hall and Murphy, 2002), and are therefore hardly used. Arguments can also be made in favor of, for example, re-pricing, which can increase incentive and retention effects (Core et al., 2003).

TREND 2: A shift toward an increase in equity-based compensation and new forms of long-term incentive plans.

Besides the identified shift from traditional stock option plans to other forms of equity based payment, we observed a strong increase in the number of companies that have implemented deferred bonus plans. At the time when we conducted this study, it was expected that in 2005, 25.4% of the companies would have implemented such a plan, often in combination with performance shares. They are the most popular among AEX companies. Besides these plans, there is also an increasing focus on the so-called 'shareholding requirements'.

[13] The Tabaksblat Code states that 'options shall not be granted at an exercise price lower than the market price at the grant date'. It furthermore states that 'neither the exercise price nor the other conditions shall be modified during the option term'.

Although quite a number of companies have redesigned their option plans, mostly by including performance standards, it is to be expected that in the near future only a few, or perhaps even none, will hold on to these option plans. Companies themselves, however, shed relatively little light on their motivations to change the composition of the variable pay package.

Negative reputation of options and the symbolic value of shares

After the corporate scandals in the beginning of the 21st century, and in particular the Ahold scandal in the Netherlands, (large) stock option packages were considered as one of the factors that had triggered these events. It is believed that executives, being motivated by large option grants, became fixated on share prices and started to take excessive risks, which led to these scandals (Hall and Murphy, 2003). This has stimulated the development and introduction of other, more socially acceptable, forms of equity-based compensation, of which the performance share is the prime example. The preference for shares to options has been explicitly expressed by compensation and corporate governance experts as well as (be it more implicitly) by institutional investors. From a corporate governance point of view therefore, shares are clearly favored. Thus, in order to avoid being criticized by society in general and investors in particular, a switch to performance shares is the best and definitely the easiest way to go for remuneration committees.

This shows that the implementation of performance shares and deferred bonus plans also has a great symbolic value. By implementing a performance share plan, companies: a) show that they take an interest in aligning the interests of managers and shareholders and b) show their commitment to good corporate governance standards. Westphal and Zajac (1994) found evidence that the adoption of a long-term incentive plan is often used in a symbolic context. By adopting such a plan, companies give proof of their legitimacy and show the investment community that they take its interests to heart.

The increased adoption of performance share plans and deferred bonus plans can also be a reflection of ‘copycat behavior’, which is closely related to the legitimization argument. To remuneration committees, who are expected to provide an economically sound and transparent pay package, the remuneration practices of other ‘leading’ companies provide an excellent yardstick (Girma et al., 2002).

Technical considerations in favoring shares

Besides symbolic advantages, performance share or share retention plans have some fundamental characteristics that make them more attractive and reliable than stock options. Options appear to have a number of negative incentive effects as compared to performance shares. First, since options only reward stock price appreciation, executives are given the incentive to cut dividends (Lambert et al., 1989). Second, payout is not so much dependent on relative performance evaluation, but more on general market trends. Although performing poorly, executives can still profit from huge windfalls by cashing in on their options in a bull market. On the other hand, they may get punished for a good performance in a bear market (Bebchuk and Fried, 2004). Third, large option grants can increase the dilution of share capital, thereby lowering shareholder value. Finally, since stock option plans have a fixed term, stock option pay is susceptible to 'pump and dump' behaviour and earnings management. As a consequence, doubts have risen regarding the effectiveness of stock option plans, which might have resulted in the switch to other forms of equity-based compensation.

Ever since the bull market in the '80s (when options were first introduced on a large scale), executives have continuously benefited from large option exercise gains. It is therefore not surprising that from the executives' point of view, options are a favourite form of compensation. After the crash of the Internet boom in 2001, however, all outstanding option grants were washed away, with little prospect of any payouts in the short-term. The drawbacks of option plans in an economic bear market became clearly visible and alternatives were sought that would offer the executive a more stable payout. In the case of performance shares, payout is still granted even when the stock prices are decreasing (payout depends for the largest part on the attainment of the performance condition); the gains being in general less, however, than when the stock prices increase. Performance shares therefore also offer incentives when the share prices have declined; whereas if stock options lose their value, incentives are lost since a positive payout is no longer likely to happen.

The key factor that most probably triggered the switch from options to shares is the introduction of the International Financial Reporting Standards (IFRS 2). Under IFRS 2, companies have to account for their option grants in the Profit and Loss Account. This has created a playing field among all equity-based compensation, taking away the financial advantages of stock options. In addition, the Dutch tax regime has changed, which has abolished the preference for stock options. For example, Perry and Zenner (2001) have found evidence that the regulatory system has a considerable effect on the compensation decisions of remuneration committees. Since the clear advantages of stock option pay have disappeared, its efficiency has clearly diminished, offering possibilities for other forms of long-term incentive pay.

TREND 3: Sharp increases in the value of the executive's total compensation package triggered by a rise in equity-based compensation.

The analysis on the total compensation of executives shows that, in particular, the executives of companies that introduced performance shares witnessed large increases in the value of their equity-based pay package. Companies that introduced performance shares in 2003 or 2004 saw a median rise in the value of their equity-based pay package of 127%. Companies that kept the same LTI package had an increase in value of 35%. This figure does not even include the value increases caused by deferred bonus plans, often implemented at companies that had also introduced performance shares. We can therefore conclude that the introduction of performance shares has led to a significant rise in the value of the pay package.

The analysis also shows that companies that stuck with their stock options witnessed a decrease in grant value of 46% (2002-2004). Companies that introduced performance shares and also held on to stock options (in a performance unit plan or two separate plans) saw a median decrease of 32% in the option package value in the period 2002-2004, which included an increase in value of 33% from 2003 to 2004. Whereas one would expect to see sharp decreases in stock option grant value at companies where performance shares had been introduced (to make the switch on a cost neutral basis), this has not been the case. Besides the value increases that the introduction of performance shares has brought to the package, the remaining option grant value has also increased.

Increasing share prices and a preference for equity-based pay

First of all, there is a rather technical explanation for the increase in value of the equity-based compensation package. We have established that almost 30% of the companies award options on a fixed number basis, and that there is a considerable number of other companies that partly base their grants on fixed numbers, such as companies that award options on a discretionary basis. The options granted in the spring of 2002 (the usual time to grant options) were still subject to relative high exercise prices (AEX=500). However, one year later, most stock prices had dropped considerably (AEX=300), followed by a (relatively small) bounce up again in 2004 (AEX=350). As a result, companies offering a fixed number option (or share) package saw the value of the package decrease significantly in 2003, to increase again in 2004. Thus, the basis on which options or shares are granted has significant consequences for their value. The data also show this; the grant values significantly dropped in 2003 compared to 2002. On the one hand, one could argue that executives may either profit from share price increases or get punished for share price decreases in the value of next year's grant, but on the other hand, this way of granting could also lead to equity grants of inefficient sizes (too large or too small to stimulate incentives).

The fixed number explanation, however, only partly accounts for the increases that have been observed. Probably the most important explanation for the large increases in value of equity-based compensation is that many companies have deliberately enlarged this part of the pay package. The appreciation for equity-based compensation (and in particular shares) has steadily grown in the Netherlands due to the strong alignment of the interests of shareholders and managers. In the Dutch corporate world, more emphasis is placed on good corporate governance and shareholder value creation, and combined with an increased shareholder pressure that is legitimized (Westphal and Zajac, 1994); equity-based compensation has come to be regarded more and more as an important component of the pay package. To keep compensation packages competitive, companies have enhanced their equity-based pay following a number of 'leading' companies, thereby making a large equity-based pay package common market practice.

In addition, a growing number of companies have indicated that they strive for an at target 1/3 fixed, 1/3 short-term variable and a 1/3 long-term variable composition of the total pay package. In particular, the 1/3 long-term variable part had to be increased to amount to a value of 100% of the base pay. However, many companies have already surpassed this 100%; the median equity-based pay value at AEX companies has already amounted to 101% of the base pay in 2004 and is still increasing. It is therefore expected that in the future, the long-term variable part of the pay package will rise only further and play an increasingly important role in the pay package of Dutch executives.

Foreign executives and valuation consequences

Another explanation for the growing preference for equity-based compensation might be the rise in the number of foreign executives in the Dutch boardroom. In 2004, almost 50% of the CEOs of the 25 largest Dutch (AEX) companies were foreign, whereas this was only 25% in 2002. These foreigners, in particular Anglo-Saxons, often have different attitudes toward the level and structure of executive pay since it is, in general, higher in their country of origin and more closely aligned with shareholder value. Foreign executives are usually also more internationally focused and like to compare their pay packages to those of international competitors, which often consist of higher amounts than the pay packages of major Dutch firms, and which have a clear pay-performance relationship. Drawing solid conclusions about a causal relationship between the number of foreign executives and the height and structure of executive pay is, however, not possible since the data are, in general, too limited. What we unmistakably see here, however, is a trend that could significantly impact the future of executive compensation.

Finally, one could argue that supervisory board directors have not been sufficiently aware of the actual changes in value that the switch from options to performance shares has caused. The valuation techniques used in this study may be distinct from those used by supervisory directors and consultancy firms. As a consequence, the calculations made by supervisory board directors might have resulted in different outcomes, causing them to underestimate the real fair value of the grant. Instead of making the switch from options to shares on a cost neutral basis, the total equity-based pay package has consequently increased considerably. This explanation, however, only applies to a few single cases since many companies explicitly state that increases in LTI value were consciously planned.

6. POST-RESEARCH DEVELOPMENTS

In the years following the above research, the continuation of the identified trends could be observed. Even though there have not been any updates to the Dutch Corporate Governance Code, the prescribed guidelines, in combination with a large degree of public scrutiny, have led Dutch executive compensation arrangements to be continuously similar among companies. In the years following our research, more companies have replaced their stock option plans and replaced these by performance share plans, the large majority with relative TSR as (one of the) performance measure(s). Furthermore, the total compensation value of executive packages has increased further in the following years, primarily caused by larger LTI grants.

There is a remarkable similarity visible with remuneration structures in the UK as they were a couple of years ago. After the implementation of several corporate governance guidelines and the strengthening of investor associations, remuneration packages developed in a similar homogeneous way as now visible in the Netherlands. Not coincidentally, the structure of remuneration is very similar in both countries, unlike those in other continental European countries. The Dutch Corporate Governance Code was heavily inspired by the UK Combined Code, and influential remuneration consultants looked closely at UK practices. Furthermore, there is a large degree of compulsory disclosure in both countries which stimulates copycat behavior.

It is, therefore, interesting to see whether Dutch remuneration structures follow a similar path as UK structures did in the last couple of years. After executives and remuneration committee members realised that the standardized structures were not that effective in providing incentives and a fair reward for performance after all, remuneration packages have diversified into more company specific arrangements, although they still remain heavily influenced by guidelines and scrutiny. A similar pattern may appear in the Netherlands (first complaints of executives have already appeared in popular press), and now the moment is there that the first cycle of new structures is up for review. It will be interesting to see whether one will stick to this uniform design or go for a more company specific, and likely more effective, design.

7. CONCLUSION

This study has reviewed the Dutch executive remuneration practices and identified several trends. The first major trend that we identified is that in recent years, the structure of many incentive plans has been revised and that a renewed focus on the discretionary powers of the supervisory board has emerged. Under the influence of the Tabaksblat Code and outside investor pressure, many companies have added performance conditions to their option and share plans and have made sure that the bonus plan measures are 'previously determined, measurable and influential'. The most recent type of Dutch executive compensation, relative TSR performance share plans, might on the one hand seem an appropriate and responsible way to reward an executive (since companies have to perform better than their competitors), but on the other hand, the complexity of such plans might lower their value from the executives' point of view.

Thus, are Dutch executive compensation arrangements effective? The large increases in pay have certainly improved the position of Dutch companies in their quest for international top managers. One could question, however, whether the current pay levels are really necessary to attract and retain executives, and if these levels are therefore efficient. Furthermore, it is questionable whether money really is the key driver of an executive to join and stay at a company, and if this focus on pay arrangements actually crowds out the executive's intrinsic motivation.

Although Dutch managerial pay packages have increasingly been composed to motivate executives, it is questionable whether they really do since firm- and manager-specific variables seem not to have been taken into account. Corporate governance requirements may furthermore limit the possibilities for an optimal design from an incentive point of view. This suggests that the current pay packages might not be optimal to provide the best incentives to motivate executives.

Overall, however, Dutch pay packages seem to increasingly reward executives in an effective way. Incentive plans are more and more designed to avoid any perverse incentives and prevent windfall gains, which are not earned by performance, but merely by sheer luck. Obviously, perverse incentives cannot be completely ruled out. We can conclude, however, that the incentive plan design seems to have improved for the better in the past few years.

On the other hand, a growing number of companies have made part of the annual bonus payout dependent on the discretionary judgment of the supervisory board. This suggests that supervisory board directors have become more engaged in the pay setting and performance evaluation process.

The second major trend is that new forms of long-term incentive arrangements have been introduced. In particular, performance share plans have replaced option plans, and deferred bonus plans have been added to the pay package. This seems to have been triggered by the negative reputation of stock options, the fact that performance shares are, in general, reviewed more positively (and are therefore considered as legitimate by the investment community), copycat behaviour, fundamental flaws in the option plan design, the more stable payout that performance shares offer, the compulsory expensing of stock options under IFRS 2, and a changed tax regime. Furthermore, a great deal of effort has been put into eliminating the risk of perverse incentives.

These findings lead to some remarkable conclusions. First of all, the new regulations (Tabaksblat Code, IFRS 2) have had a clear effect on the structure of executive pay arrangements. Although not legally binding, most companies have chosen to comply with the principles of the Tabaksblat Code, most likely for reasons of legitimization. However, these principles do not always need to be efficient from an economic point of view. Hall and Murphy (2002) argue that long vesting periods, and quite likely also performance conditions, lower the ratio between the value as perceived by the executive and the cost for the company, thereby lowering the incentive levels. Therefore, one could argue that the principles laid down in the Tabaksblat Code, which constrain the above-mentioned practices, might not be efficient in an economic way. Furthermore, the tendency of remuneration committees to attach ever more vesting restrictions to long-term incentive plans, might not be the best way to motivate executives who may no longer be able to see the link between behavior and payout.

This research has offered a profound insight into Dutch executive compensation practices. It is, however, not without limitations. It focuses on a relatively small selection of Dutch companies. This means that the research results specifically apply to this particular sample and are difficult to generalize to other research populations. The limited size of the Dutch corporate sector has, however, prevented a broader scope. Still, the population consists of many large multinational companies that compete in an international environment. In their specific context, the results of this study can therefore be compared with those of other studies conducted in, for example, the US and the UK, which also focus on the major companies. Having provided initial insights into this topic, this study could serve as a valuable starting point for future research into executive compensation arrangements in the Netherlands, providing a broader understanding of the efficiency of Dutch executive contracts and the influence of political interference on these contracts.

What makes the findings of this paper particularly interesting is that they show the specific situational context in which executive compensation arrangements are made in the Netherlands. We have identified clear trends in equity-based pay, which have evolved in a context of specific regulatory requirements and environmental pressures. Furthermore, the questions about the economical effectiveness of the current arrangements have been raised.

Additional research could also be directed at the effects of external benchmarking on the level and structure of executive pay. Does external benchmarking lead to a racketing-up of pay and does it crowd out the intrinsic motivation of executives? Another interesting topic of research could be the degree of managerial entrenchment in the Dutch corporate governance system. Most research on this issue has, so far, explicitly focused on the characteristics of the Anglo-Saxon unitary governance system, but given the specific characteristics of the Dutch governance system, it might be useful to initiate a study on the basis of this specific context. Does managerial entrenchment have effects on the Dutch executive pay arrangements? Particularly interesting could be the question whether executives are able to influence the composition of the benchmark group, which might result in large pay increases.

Although this research has offered an insight into the Dutch executive compensation practices, it is not without limitations. It specifically focuses on a relatively small selection of Dutch companies. This means that the research results apply specifically to this particular research sample and are therefore difficult to generalize to other populations. The limited size of the Dutch corporate sector has, however, prevented a broader scope. Still, the population consists of many large multinational companies that compete in an international environment. In their specific context, the results of this study can therefore be compared with those of other studies conducted in, for example, the US and the UK, which are also focused on the largest companies. Most observations in this paper have been based on a combination of a qualitative assessment of the empirical research results and a literature study, and can therefore not always count as scientific evidence. They *can*, however, serve as a trigger for future research into compensation practices in this unique situational context.

A final interesting subject for future research might be the consequences of the introduction of relative TSR plans, which in recent years have been introduced massively in Dutch companies and are often considered as having significant value. In particular, the question of how executives perceive the value of these kinds of plans in comparison with the company's costs might considerably increase the insight into the incentive effects and efficiency of these plans. This study may serve as the basis for many other interesting topics for future research.

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TRENDOVI U KOMPENZACIJAMA NIZOZEMSKOG TOP MENADŽMENTA

Sažetak

U ovom se radu opisuju trendovi u dizajniranju ugovora o plaćanju nizozemskih top menadžera. Da bi se unaprijedilo poznavanje ovog problema, analizirani su podaci o kompenzacijama izvršnih članova odbora direktora 71 nizozemske korporacije uvrštene na tržište kapitala u periodu od 2002. do 2004. godine. Rad polazi od premise da specifični režim korporacijskog upravljanja i uvjeti u okruženju presudno utječu na ugovore o kompenzacijama. Na temelju teorijskog istraživanja, u kojem se kombiniraju empirijski rezultati i pregled literature, ustvrđuje se da se optimalni pristup kompenzacijama postiže kompromisom između poštovanja standarda korporacijskog upravljanja (na temelju kojeg se optimiziraju potencijalni poticaji i smanjuju negativni poticaji menadžmentu) i težnje za ponudom konkurentnog paketa kompenzacija. Čini se da se ovaj kompromis razlikuje u svakom poduzeću, kao i u vremenu u kojem se promatra. Relevantnost ove studije je dvostruka: prvo, njezini rezultati bi mogli pomoći u oblikovanju javne debate o plaćanju top menadžmenta u Nizozemskoj. Nadalje, ona može poslužiti kao nacrt za buduća istraživanja na temu kompenzacija top menadžmenta u specifičnom kontekstu nizozemskog sustava korporacijskog upravljanja, kao i pomoći u kreiranju optimalnih kompenzacijskih paketa.

APPENDIX I. POPULATION FOR THIS STUDY

AEX	AMX	SMALL CAP
ABN AMRO	Aalberts Industries	Arcadis
Aegon	AM	Athlon Holding
Ahold	ASM International	Ballast Nedam
Akzo Nobel	BAM Groep	Boskalis Westminster
ASML	Corio	Draka Holding
Buhrmann	Corus	Eriks Group
DSM	Crucell	Euronext
Fortis	CSM	Frans Maas Groep
Getronics	Fugro	Gamma Holding
Hagemeyer	Heijmans	Grontmij
Heineken	Laurus	Imtech
ING Groep	LogicaCMG	Kendrion
KPN	Nutreco	Macintosh Retail Group
Numico	Océ	OPG Groep
Philips	Randstad	RSDB
Reed Elsevier	Rodamco Europe	Schuitema
Royal Dutch Shell	Stork	Sligro Food Group
SBM Offshore	Van der Moolen	Stern Groep
TNT	Vastned Retail	Telegraaf
Unilever	Vopak	Ten Cate
Vedior	Wereldhave	TKH Group
Versatel	Wessanen	Univar
VNU		USG People
Wolters Kluwer		Van Lanschot
		Wegener