The Executive Compensation Debate

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I think it was the Financier Leo J. Hindery Jr who once said: 'I think there are people, including myself at certain times in my career, who because of their uniqueness warrant whatever the market will bear.' But the questions beg HOW much is too much? and Should macroeconomic woes slow CEO pay growth?

I recently read in the Associated Press that even as the economy slowed down in America â€œCEO pay still chugged to yet more dizzying heights last year.' The top 10 highest paid CEOs took home a total of more than $500 million, but half of those companies saw huge drops in profitability at their companies.

One of the most exasperating things to shareholders and the public is when a CEO receives millions or tens of millions of dollars of compensation regardless of performance. This practice goes fundamentally against the culture of rewarding on the basis of ability and merit that underpins the free market system. Recent examples include: Marriott International chief J Willard Marriott Jr - his 2007 pay was $44m, up 22%, just six percentage points lower than Marriottâ€™s stock price drop or Stan Oâ€™Neal, Merrill Lynchâ€™s former boss, left with $159m after losing $8 billion.

Shareholders and politicians are advocating bringing in rules for companies that would allow shareholders to vote on executive pay. Executives in Europe have home far less compensation than their American counterparts in the past. But with leadership compensation in Europe on the rise, these pay increases have citizens in European nations deeply unsettled. The public indignation on both sides of the Atlantic has contributed to a unique political debate over what to do about excessive executive pay. Executive pay figures in Asia are still not as widely accessible as in Europe and America and it is difficult to compare. A recent study conducted by the CFA Institute Centre for Financial Market Integrity said that reporting compensation of executives on an individual basis is the practice in the United States, Britain and Australia and is advocated by institutional investors worldwide. Prevailing regulations and practices in Hong Kong, Japan and Singapore however leave much to be desired.

Jean-Claude Juncker, president of the European Commission's â€œEurogroupâ€ of finance ministers, recently called excessive pay a â€œsocial scourgeâ€ and demanded action. When L'Expansion, a French business magazine, calculated that pay for the country's bosses went up 58% in 2007, the finance minister, Christine Lagarde, said it was â€œscandalousâ€ and threatened regulation. Nicolas Sarkozy, president of France, and Horst Kâ¶hler, president of Germany, have also denounced high pay.

New legislation the Netherlands will see the law setting EU500,000 as the level of annual salary or severance payment at which extra taxes must be paid. Germany's Social Democratic Party is calling for legislation to curb pay, though its partner in government, Angela Merkel's Christian Democratic Union, has so far resisted. At the same time the European Commission is working on a response to the Eurogroup's complaint.
Just how extreme is executive pay in Europe? As European firms compete for global talent it certainly has risen substantially in the last 10 years. Foreign executives now run seven of the firms in France's CAC 40 index and five of Germany's DAX 30. American-style bonuses and long-term incentive plans are now commonplace.

However European firms still pay a fraction of what is paid to their counterparts in America. According to Hay Group, a management consultancy, the median European executive earns just 40% as much as his equivalent in America. It's also notable that both American presidential candidates - John McCain and Barack Obama - have been making compensation a campaign issue.

There is an important difference though companies in Europe seem to be more determined than American ones to link compensation to performance. In America share grants are often not tied to performance, whereas European firms usually attach performance criteria to any share grants, typically depending on a comparison with a peer group. Dan Vasella, boss of Novartis, a Swiss pharmaceutical giant, and a favourite target of pay activists, earned SFr17m ($14m) in 2007, down 33% from 2006, because he missed his targets.

The extreme rise in European executive pay has sparked an intense debate in countries that have been characterised by a relatively strong sense of economic solidarity and impartiality in the past several decades. A July 2007 Financial Times/Harris public opinion poll found that over 60 percent of those surveyed in the UK, France, Italy, and Spain would like to see their government set caps on top business executive pay. In Germany, a 47 percent plurality supports pay caps.

In America, only 32 percent of the public supports an outright pay cap on executive earnings a recent poll shows. However 77 percent of Americans say corporate executives 'earn too much.' Some members of Congress have responded by introducing legislation to curb excessive pay through tax reform and giving shareholders the right to vote on pay packages.

I recently saw an interview with Sarah Anderson, who compiles the Executive Excess report on CEO pay on a yearly basis. She discusses some of the issues raised in this column in her interview and I recommend that you take some time to view it. (http://www.youtube.com/watch?v=X2lKfRFhG0M.)

From what I have read and heard in the last year signs point to a strong possibility that meaningful reforms to rein in excessive executive compensation could be a prospect, as many political leaders in Europe and the United States seem to be finally catching up to the public uproar. It has to be said though that compensation is a complex issue. Different circumstances and industries dictate different packages and even severance pay may be justified if a change of control is the end goal. One would hope though that politicians would reject laws about pay, which are too widespread to be useful. Strict legislation might well compel leaders away from listed companies and create compensation packages even more complex and so much more difficult to monitor.

About the Author
Alain Tanugi has over 30 years experience in Executive Search. Prior to co-founding TRANSEARCH, he was the Managing director of a well-known French recruiting firm that he founded in 1975. Previously, he was Managing Director of a Paris-based firm dealing with career counselling, outplacement & training. Alain is Chairman of the Board of TRANSEARCH International Partners Plc and heads its global Board Practice.