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CEO Pay Ratios: Populism or Good Governance?
By Shai Ganu

Excessive CEO pay has been the subject of extensive media coverage, adding pressure on boards and regulators to respond appropriately.

Some regulators are considering implementing, "CEO pay ratios" – which address the relationship between CEO (or senior-executive) pay with the pay of other employees in the company. Most rules require only disclosure, but some proposals would cap CEO pay at multiples of average or median pay of all other employees.

What Are CEO Pay Ratios?

Reports supporting CEO pay ratios often quote management consultant Peter Drucker, who in the 1970s recommended that companies publish a "corporate policy that fixes the maximum compensation of all corporate executives... as a multiple of the after-tax income of the lowest paid regular full-time employee.", suggesting that "the exact ratio is less important than that there should be such a ratio".

Recent media articles suggest a 300-to-1 CEO-to-employee pay ratio in the US. A 2016 survey by Mercer of 117 US companies across 12 industries found an average ratio of 200-to-1 or less at the majority of companies, but 20 per cent reported ratios of 400-to-1 or higher. Industries with more professional staff have lower ratios than those with more part-time, temporary and lower-skilled employees. The lowest ratios are in the financial services and technology sectors, while the highest ratios are in retail, wholesale and consumer goods.

Supporters contend that properly structured CEO pay ratios allow boards, investors and proxy advisors to make comparisons across similar companies, while determining senior executive pay. However, for this to be truly effective, companies need to be transparent, and there must also be a consistent definition of the numerator and denominator.

The push for stricter measures

While many jurisdictions currently require public companies to disclose the compensation of their CEOs, few require disclosure of CEO pay ratios – though the US, the UK, Germany and the EU are beginning to do so.

From 2018 onwards, US public companies will be required to report the ratio of CEO-to-median-employee pay. In the EU, as part of a proposed binding "say-on-pay" vote, companies would be required to discuss the ratio between the average pay of directors and that of other full-time employees. In the UK, companies have to disclose the percentage change in CEO payments from the prior year, and average percentage change for all of the company's employees - not actual pay ratios per se.

Meanwhile, some regulators and investors are pushing for more proactive measures that go beyond mere disclosure. For example, in France, companies have a maximum 5:1 ratio between the largest and smallest awards of free shares (i.e. restricted shares that may receive favorable tax treatment) that may be granted to employees.

There have also been proposals that were not adopted. For example, in California, the senate narrowly voted against a bill that would have tied the state corporate tax rate to a company's CEO pay ratio. In Switzerland, despite initially striking a populist chord, a proposal to limit executive salaries to 12 times the pay of the lowest paid employee was rejected in a national referendum by a margin of nearly two to one.

Although not enacted, these still indicate public sentiment and concerns around executive pay levels. Similar proposals may appear in the future.

Practical considerations, and limitations

Regulating CEO pay ratios is likely to have positive and negative implications.

On the one hand, questions may be raised about the fairness of an individual employee's pay relative to the company's median or average pay. Indeed, they may fuel efforts to increase the minimum wage, or lead to campaigns to cap pay or penalise companies with high pay inequity.

Indeed, ratios may prompt companies to consolidate payroll and human resource information systems to more easily collect and analyze data. These could also provide an additional approach to benchmarking how executive pay levels are set.

That said, it is also important to consider how pay ratios are interpreted. For example, a low ratio could simply mean that a company has outsourced jobs to workers who are no longer on the company's payroll.

Or, it may reflect typical compensation levels in a given industry. For example, financial service companies, which employ highly paid workers, are likely to have lower ratios than large retail companies, which have many lower-paid hourly workers.

Also, the numerator in the pay relationship may reference average executive pay rather than CEO pay. What's more, some companies may have just one senior executive while others may have, say, five. All these considerations limit comparability across companies.

More importantly, the empirical evidence is still unclear about whether pay ratios have actually helped curb executive pay.

Singapore pay

There are currently no obligations to impose CEO pay ratios in Singapore. The 2012 Code of Corporate Governance only makes basic demands on the disclosure of top executive and director compensation. Yet, Singapore companies have considerable room for improvement regarding compliance with these provisions on remuneration.

Companies are encouraged to enhance disclosures to shareholders on remuneration-related matters, lest the regulators be prompted to step in and implement measures that require stronger disclosures, including, potentially requiring companies to report CEO pay ratios.

The writer a member of the Governing Council of the Singapore Institute of Directors. This article first appeared in BTInvest, http://www.btinvest.com.sg/specials/boardroom/ceo-pay-ratios-populism-or-good-governance/