

CEO pay to go backwards?

CEO and Executive pay levels are often a source of contention, particularly in New Zealand where an egalitarian approach to most things pervades our culture. Questions regarding just how much value a CEO adds to a business are complex and not easily answered. One thing is for certain though; it is often a difficult job, and higher levels of compensation have historically been one of the rewards for this.

Now, as the recession continues to bite, the top job is getting tougher. At the same time, pay levels may be going backwards, or at the very least, stagnating.

So what are the causes? The two biggest influences are:

1. Reaction to 'Pay for Failure'
2. Reaction to the deepening recession

Reaction to Pay for Failure

International furore over 'pay for failure' for outgoing executives has put CEO and executive remuneration under the spotlight. Many governments have taken an active role in damning private sector practice and legislating to address these issues.

In the United States, President Obama recently put a \$500,000 limit on the annual pay of bank executives whose firms received government assistance during the financial crisis. He said these guidelines were just the beginning of a long-term effort to realign the way business leaders are paid, beyond the banking industry and other bailed out firms.

Those affected by this specific initiative may be a limited group. But the wider question is the extent to which changes in this industry will affect others.....

The pressure to develop defensible remuneration packages may have started as a government-led intervention, but in the fullness of time, this responsibility won't be a government one. It will sit fairly and squarely with the Board of Directors. As CEO performance is assessed against their salary, so too will Directors be assessed on how well they have set (and managed) the CEO's pay.

Reaction to the deepening Recession

In addition to shareholder/public pressure to keep CEO salaries modest, there is another more pressing reality impacting our industry leaders' salaries.

Many long-term incentive returns are now at depressed or negligible levels. However, CEO's won't be able to look to increased Base Salary (or more generous short-term incentives) to make up the shortfall. Not with all costs very much on the radar.

Globally, total earnings for CEOs are falling.

Under-performance in the form of decreasing revenues and contracting markets is putting significant pressure on company's cost structures. CEOs and executives are being looked to, to demonstrate leadership and reduce their salaries, as one of many measures aimed at reducing costs.

Locally, we are no exception, with a swathe of CEOs (and sometimes their executive teams) stepping up to the plate. The CEO's and Managing Directors of some of our highest profile companies like Air New Zealand and ASB have already announced that they have taken a pay cut. Air New Zealand's CEO Rob Fyfe said he had taken a pay cut of more than 20% in the 12 months to June. He said it was only fair that as business performance went down, so did pay. It's a logic that's hard to argue. The Managing Director of EDS for Australia and NZ has also taken a pay cut to the tune of 10%; while TVNZ CEO Rick Ellis said he would be very surprised if impending cost cutting at the broadcaster failed to affect his salary.

The remuneration market won't take long to reflect these CEO salary freezes, cuts or very modest increases. Historical year-on-year movements in the vicinity of 7 – 10% seem unimaginable for the 2009 – 2010 year.

These market data findings will roll into Board pay decisions - if no movement is demonstrated by the market, justification to move salaries is harder to find. As well, increasing unemployment means labour market pressure has eased, and talent at all levels is more readily available.

All these factors mean that at best, CEO pay is likely to stagnate. But, it is more likely to actually contract in the short-to-medium term. So pause for a moment, if you will, before launching an attack on these so called 'fat cats'. Right now, it's tough all over.

For more information on this topic, please contact Strategic Pay

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