What Price a Good CEO?

Third in line after company cars and the MD's secretary's salary, the most controversial issue in remuneration is the CEO's pay. In this article, we look at fixed remuneration.

CEO salaries regularly hit the front page overseas, but seldom in New Zealand, where pay is still relatively egalitarian. A look at the last 10 years suggests this is changing fast. In the Higbee Schäffler 2008 Corporate Services & Executive Management Survey, median fixed remuneration for top tier CEOs was around $690,000, with STIs adding around another $250,000. With the average wage at just over $49,000, group CEOs in New Zealand typically earn 14 times in fixed pay what the average employee earns.

How has this changed? In 1998, the average wage was just on $33,300. It has increased by almost 50% in the last 10 years. Remuneration data from 1998 indicate the median pay for a CEO was between 6.5 and 11 times that (about $215,000 and $356,000 for medium and large companies - STIs that year were negligible). The increase in fixed pay over 10 years? About 100%.

Why is CEO remuneration growing so fast? The popular theory is that remuneration consultants are to blame for everything, but we don't believe we have that level of influence. Decisions of CEO pay are made by Boards. Data from our latest survey indicates that remuneration budgets were carefully aligned with forecast increases, with the exception of two groups – senior managers and executives, who received higher increases than forecast.

Pay, in theory, exists for two key purposes – reward and motivation. In terms of reward, the CEO's job carries the greatest accountability, and most industries are increasing in complexity. CEOs work extremely hard. Their jobs are often thankless. One could also argue that CEO's skills are increasingly sophisticated and that their economic contribution far outweighs any remuneration.

However, has this really changed in the last decade? New Zealand companies in 1998 were operating in a recession in the world's least protected economy. Most had already been through significant pain and were well aware of the need to maximise the return from every dollar invested. GDP per capita in 1997 placed us 20th in the OECD, behind Ireland. In 2007, we were 22nd.

Then there is motivation. What really motivates CEOs? While this may sound heretical, it is doubtful that money per se has much to do with it. Does anything more than $10,000 per week affect someone's current or future lifestyle in New Zealand so greatly that they will work 30% better for another $3,000 a week? Does a CEO earning $534,000 produce inferior results to a CEO earning $700,000? It's likely that the answer to all these questions is 'No'.

Motivation is far more likely to come from achieving a good result in a tough environment, from belief in the industry, from the fact dozens, or hundreds, or thousands of people have a job because of what you do.

So, if it's not reward, and it's not motivation, what is driving CEO remuneration?

Partly – supply and demand. Many New Zealand companies have strong, internally grown executive teams. They don't recruit externally, and their CEOs are often longstanding employees with an immeasurable font of industry knowledge. Ideally, the next CEO is obvious and groomed for the role.

Flat organisation structures can, however, result in a CEO having 8 or 10 direct reports and often no obvious successor. The CEO's departure can result in a tricky recruitment exercise with a limited pool of credible candidates. Such candidates are not renown for their shy, shrinking personalities or poor negotiations skills. Although a CEO is the epitome of a position that should attract a performance-based package, sizeable guaranteed pay is often negotiated. The labour market affects CEO pay in just the same way as it affects other remuneration. Turnover among senior executives was 17% in the year to February 2008 and is likely to have had some influence on pay.

Supply and demand for CEOs, as for everyone else in the market, has led to an undue focus on market relativity, insufficiently balanced by all the other factors that should contribute to remuneration strategy. As more information is publicly available, CEOs and Boards have become well aware of pay levels in listed companies. Market relativity, rather than internal considerations or straight $ earned, appears to have become the number one remuneration determinant.

Would our CEOs still be in their jobs if their pay overall had increased at 50% over 10 years instead of 100%? I would bet that 99% of them would be. Would one individual be in his or her job if their salary had increased at half the level of their peers? While there are always exceptions, the answer in most cases is - most unlikely.

The answer to increased pay pressure? Grow your CEO internally, assess whether pay reflects performance and not market relativity alone, find other forms of kudos and recognition and take a firm line on fixed pay in the Board room.