

Who should have a say on pay?

The global executive remuneration dust-up and what it means for NZ...

While criticising fat cats, tall poppies and greedy beggars has always been a popular sport in New Zealand, the topic of CEO and executive remuneration has never been so contentious.

Like many things, the trend started offshore. The global financial crisis has led to widespread consternation on, not only executive salaries, but specifically bonuses and severance payments. The greed of assorted players in the financial services sector is believed by many to be the driving force behind the unprecedented collapse of global banking, investment and property markets. Yet, it's in this very industry that payments to departing CEOs and executives have hit the headlines. Their remuneration practices have become a cautionary tale.

President-elect Barack Obama is a strong proponent of 'Say on Pay' legislation in the United States. He is on record as supporting this bill that would require corporations to offer a nonbinding shareholder vote on executive compensation. His deep seated belief is that there needs to be limitations on executive compensation.

Rival candidate John McCain saw the opportunity to align with public indignation, and in rare Republican/Democrat political accord, went on record with his own support of increased accountability, "We can't have taxpayers footing the bill for bloated golden parachutes like we see in the Lehman brothers bankruptcy []. My friends, the top executives are asking for \$2.5 billion in bonuses, after they ran the company into the ground".

Essentially, the US 'Say on Pay' legislation, if passed by the Senate, would enable all public boards to vote on pay packages (including severance) for senior executives. While the vote would not be binding, the moral imperative for board members is implicit.

The concept behind 'Say on Pay' isn't new. Versions of this legislation have already been passed and are in force in the UK, Norway, the Netherlands, Sweden and Australia. With heightened scrutiny and attacks on executive pay and severances, it's believed that additional European countries may soon consider enacting similar legislation.

Of course the problem of exorbitant executive remuneration is not a new one. But, public uproar and indignation at payments made to outgoing executives in the financial services sector (which have literally crashed and burned) have added hefty amounts of fuel to this fiery debate.

Renowned financial commentator Leo Hindery Junior notes that in the US, the average public company CEO compensation is 400 times that of the average employee. In New Zealand, we're much more modest, with that multiplier being closer to 25 times. However, this issue still has the requisite heat in NZ to get Joe Public hot under the collar.

Contact Energy's recent announcement of its intent to double its Directors fees, (at the same time as hiking its prices), caused the company no end of unfavourable publicity. Again in the pre-election political race, we had unusual accord between Helen Clarke and John Key, regarding the appropriateness of Contact's proposal in the current economic climate. (The footnote to this one being that even though no base increases were made to current directors' fees, in the meantime, a number of Contact's customers had already voted with their feet).

On the flip side, Air New Zealand sent a strong message to staff, shareholders, unions and the general public with their recent announcement of salary freezes for executives. While being forced to increase prices at the front line, executives taking some personal sacrifice (as part of a range of cost reduction initiatives) couldn't fail to be a popular choice to existing and potential customers.

So, while the scale of executive remuneration excess in New Zealand may not be at the same levels as in the US, it remains a sensitive issue, and one that companies would be loathe to ignore. Is 'Say on Pay' legislation the right answer for our country? Maybe only time will tell. Those who oppose the legislation contend that taking responsibility for compensation away from directors could materially weaken the Board of Directors and their mandate. Some believe having processes in place to remove an ineffectual board would be more useful.

Opinion is definitely divided on the concept. "Shareholders need a way to make sure they get what they pay for – that their return on investment on CEO pay is justified" says Nell Minow, co-founder of the US corporate governance research group, Corporate Library. While John Castellani, president of the US business roundtable, believes that corporate boards are still the best mechanism for setting executive compensation. "While shareholders are the owners of a corporation, they shouldn't be the ones running it. Corporations were never designed to be democracies", he said.

All good food for thought.... So, what then for executive pay in New Zealand as the economic recession deepens?

'Say on Pay' or no, NZ Boards of Directors need to focus on CEO and executive pay being strongly aligned with performance. Relevant, quantitative performance measures linked to pay, which increase executives' individual accountability for company performance are more crucial now than ever. Together with this, the current economic environment and public sensitivity to exorbitant executive salaries and golden handshakes should be ignored at their peril.