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Day of reckoning for CEO salaries is approaching

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This week's call by super funds for the ratio of CEO pay to the median worker's wage in each company to be published and for a binding shareholder vote on remuneration every three years didn't really get the coverage it deserved.

Maybe that's because not all the members of the Australian Council of Superannuation Investors (ACSI), which issued the report, agreed with everything in it and there's apparently a bit of -behind-the-scenes skirmishing going on as a result.

The report, headed *Towards Better Corporate Accountability*, contained four proposals, the two already mentioned, plus giving shareholders a simple process to submit non-binding resolutions to annual meetings and annual elections for all directors of listed companies. That last one is causing the angst apparently, because it might promote short-term behaviour.

But the matter of excessive executive salaries is not going away, and seems likely soon to become the subject of legislation.

A month ago, the chairman of APRA, Wayne Byres, said in a speech that (on the subject of executive remuneration) "it seems inevitable that regulatory intervention, and a greater degree of prescription, will be required to shift practices".

The question, of course, is what regulatory intervention, exactly, and the UK and US practice of requiring the regular publication of each company's CEO to median worker wage ratio may be a good place to start.

The other idea of a binding shareholder vote on remuneration every three years is more controversial because it would only be a vote against — not for anything. Presumably the board remuneration committee that copped a "no" vote would have to go back to the drawing board and try again.

After the banking royal commission's final report, the focus has mainly been on banks, because Ken Hayne recommended that APRA "increase the intensity of its supervision" of bank remuneration frameworks, for which Mr Byres is rolling up his sleeves, and also because banks have always been the standard setters for executive salaries in Australia ever since Westpac hired Bob Joss as CEO in 1993 for a king's ransom.

Over the following five years directors of the other banks faced an annual CEO tantrum and were forced to match Westpac and then the rest of corporate Australia — beset by a wave of CEO tantrums — had to match the banks.

Around the same time, CEO and senior executive salaries were fully disclosed, by name, leading to an outbreak of what might be called "top-quartilism", in which every board tried to crowd into the top quartile of salary payers — to attract the best leaders, you understand — so the top quartile became a constantly moving target.

The other thing that happened in 1993 was the Keating government passed the Industrial Relations Reform Act, which introduced enterprise bargaining.

That was followed after 1996 by a series of legislative changes by the Howard government that — along with declining union membership — effectively crushed union power and ended collective bargaining, and that is largely responsible for the recent collapse in wages growth.

Executive pay, on the other hand, has not collapsed, although bank bonuses took a hit last year (although perhaps not enough of a hit judging by the votes against a few the remuneration reports at bank AGMs).

To a large extent we're talking about the effect of compound interest. Twenty-five years ago the average wage in Australia was about $28,000; now it's $83,450, a compound annual growth rate of 4.5 per cent. At the same time CEOs were paid around $1 million, 35 times average earnings. Now the average CEO pay of the ASX 100 is $6.23 million, a CAGR of 7 per cent. The ratio to the average wage is now 75 times.

But lately average wages have been rising at only 2 per cent and, according to ACSI, CEO salaries have been rising at 12 per cent a year. If that went on for another 25 years, average CEO pay would be $100 million and average wages $138,000 — a ratio of 724 times!

So it can't go on like this, which is why super funds want each company to publish the ratio of its own CEO salary to the median wage of its workers, and more importantly, to explain and justify it.

Some people want a legislated cap on that ratio, but the problem is that the average CEO salary across all Australian businesses — as opposed to the top 100 ASX listed companies — is actually $350,000, which is just four times the average wage.

If a benchmark ratio were set at, say, 50 times, to pick a number, there would be mass salary creep for small companies as their CEOs demanded to be closer to the big guys' benchmark.

At heart, it's about bargaining power: the workers' lack of it, and the CEOs' excess of it.

For some reason board chairmen and remuneration committees feel less able, or willing, to say no to CEOs than the CEOs are to their staff. The CEO is the fulcrum of bargaining power.

APRA thinks that the problem can be solved by introducing more non-financial targets into the incentive schemes — in his speech Byres suggested 50:50 financial and non-financial targets — but that would only make matters worse.

It seems that the more discretion boards have, the more of a pushover they are because the discretion tends to favour the executives as a result of the inherent power imbalance.

That's why the super funds want a binding vote every three years. The current non-binding vote and two-strikes rule (two consecutive votes above 25 per cent against the remuneration report results in a vote on a board spill) is proving to be powerful, but not powerful enough.

The funds want to stiffen the resolve, and the bargaining power, of boards with a binding vote.

Will it happen? Hard to say, but there is clear momentum towards greater and more detailed disclosure, and possibly regulation as well, especially if Labor wins the election.

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