Regulation may threaten pay packages

There is a regulatory truck heading down the road that executives will be able to dodge only if they start moderating their pay packages. That's the warning from PwC human resources services director for southern Africa Gerald Seegers

Around the world, there is mounting anger at the growing gap between what executives earn and what the lowest-paid workers earn. If this isn't addressed voluntarily, then there is a likelihood that regulators will step in.

"The onus is on executives to act first and ensure that regulatory intervention is avoided," says Seegers.

Discontent in Switzerland at excessive executive salaries has already led to a referendum called the Minder Initiative. It may result in perhaps the most stringent regulation in the world on executive pay. Though the proposals don't cap executive or senior management remuneration, they do give shareholders power over what they earn. Shareholders will also be required to vote on the remuneration of the company's governing bodies or boards.

New proposals

The proposal prohibits directors from receiving a sign-on bonus or "golden hello" like that given to Lonmin's new chief executive, Ben Magara, who was awarded 230,604 shares - worth about R11m - when he joined the company. This was to compensate him for the loss of various financial incentives at his previous employer, Anglo American Platinum.

The European Parliament proposed in March that fund managers' bonuses be limited to no more than their base salaries. This was in part a result of the backlash against the banking industry for its perceived role in the global recession.

There are also proposals on the table to cap variable pay or bonuses of certain executives at 100% of fixed pay, unless shareholder approval is obtained to increase it to 200%.

This is in reaction to complex bonus schemes which far exceed an executive's base salary. Barclays' new financial director, Tushar Morzaria, for example, has the potential to earn an annual award of shares of 250% of his £800,000 salary as well as a longer-term bonus scheme under which he can receive up to 400% of his salary.

Incentive remuneration up sharply

SA is seeing a similar pattern, according to PwC. It says that over the past decade or so incentive remuneration has increased significantly. "Incentives, including bonuses and share awards, used to average around 60% of guaranteed package, but now they are heading to nearly 200% of the conventional guaranteed package," it says in its latest survey on executive remuneration.

Seegers says the rule of thumb is to multiply an executive's total guaranteed package by three to get to the total package. According to PwC, the average total guaranteed package of a CEO of a JSE-listed company is R3,75m. Using Seegers' rule of thumb, CEOs are likely to be earning over R9m/year.

But SA's executives are relatively underpaid compared with their global counterparts. PwC says the median salary globally for a CEO is US$2,65m. "There are not many CEOs in SA who come close to earning a guaranteed package of R26,5m," the accounting firm says, basing its calculations on r10 to the dollar exchange rate.

Even based on the pay gap ratio, SA executives don't appear to be overpaid compared with some of their international counterparts.

Pay gaps

Among JSE-listed entities the pay gap between executives and the lowest-paid employee is 53 times. In contrast the S&P500 pay gap ratio is a staggering 204 times. In Switzerland it is 12 times and in China it is 20 times but growing.

But economist Mike Schüssler says the use of the pay gap in SA is flawed. "The biggest inequality in SA is not between someone on the shop floor and the executive," he says. "The biggest inequality in SA is between a person who does not have a job and the next level up to someone who does have a job."

According to Schüssler, four out of 10 South Africans are employed but only 2,5 of those work in the formal sector. The rest work either in the informal sector or as domestic workers. He says this low participation in the economy, one of the lowest in the world for a country not at war, is one of the reasons SA has such a high inequality rate. "It's not because executives are being overpaid," he says.

But do executives receive a fair salary compared with their staff?

The new Companies Act doesn't address how executives should be remunerated, only how the salaries should be disclosed. King 3 simply states that directors and executives should be "fairly and reasonably" remunerated.

Restraint not needed

Adcorp labour economist Loane Sharp says he doesn't agree with the notion that SA companies should be restrained in terms of CEO remuneration increases. "I would reject the idea that CEO remuneration has any relevance to a shop steward or factory cleaner. CEO and executive remuneration should be linked to company performance."

But Cosatu spokesman Patrick Craven says that if the trade unions had demanded pay increases like those given on average to the chief financial officers of JSE-listed companies in the past year, they would have been accused of being excessive.

"The gap between the top and the bottom is getting even wider. We expect our executives to get salaries which are related to the highest in the world. Yet we expect our workers to compete against Bangladesh or Cambodia. It isn't acceptable," he says.

Seegers says the 20% increase in the median total guaranteed package of a CFO is a result of incoming CFOs demanding higher packages because of a skills shortage. "Moderate increases for incumbents are in line with those of executive colleagues," he says. He contends that there has been some restraint by SA executives with regard to their remuneration packages but "not at the pace or level we expected".

"SA executives must lead the way and there is a genuine intent on the part of our business leaders to make a difference. One of the avenues being considered is to forgo a pay increase and redistribute the funds to lower-paid employees to close the pay gap and kickstart the monitoring process."

Though contentious, the pay gap is a good indicator of how companies are performing in trying to reduce the pay differentials between executives and the shop floor workers and to restrain executive remuneration. If it continues to diverge, it will become harder for executives to dodge that regulatory truck, whether their pay is fair or not.

Source: Financial Mail via I-Net Bridge