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Corporate Governance

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Is CEO pay excessive?

Performance targets, wage gaps and the South African dilemma.

JOHANNESBURG – Are chief executives of locally listed companies receiving variable pay for meeting sufficiently challenging targets?

An analysis of pay practices at Top100 JSE-listed companies by boutique fund manager Mergence Investment Managers, suggests that, on an aggregate level, performance targets may not always be challenging enough as it seems relatively easy for executives to receive a considerable variable pay package.

Brad Preston, portfolio manager at Mergence, says listed companies' remuneration policies have become incredibly complex.

Nowadays a significant portion of executive remuneration is variable, which makes a lot of sense to shareholders who want to see that executives are paid in line with the company's performance.

The downside however is that there is often not sufficient disclosure.

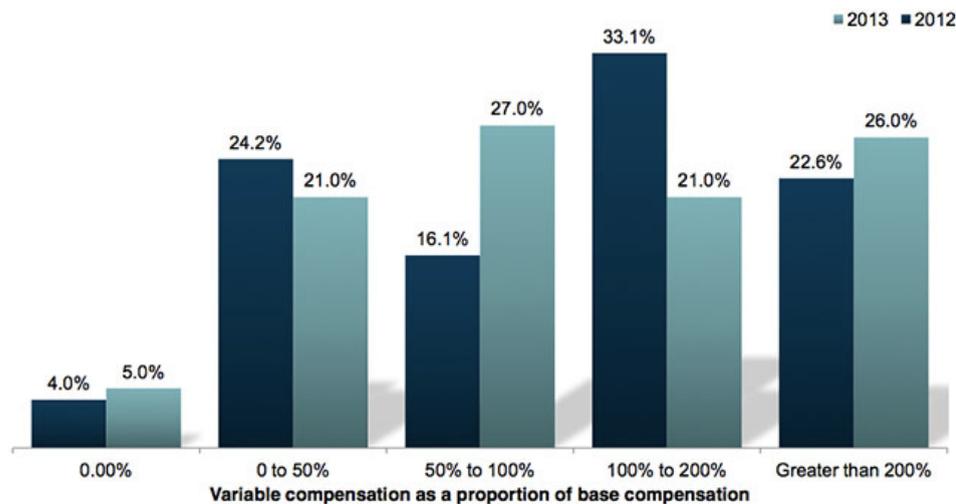
Preston says targets are put in place and bonuses are paid based on targets, but the targets are often not fully disclosed to shareholders.

Mergence's analysis of variable pay packages in 2012 and 2013 suggests that roughly 50% of CEOs within its sample received 100% or more of their base pay in variable remuneration. The other half received between 0 and 100%.

The table below shows that in 2013 26% of CEOs received variable pay of more than 200% of their base compensation. 74% received 50% or more of their base pay in bonuses.

Variable vs Fixed Compensation

How easily do CEOs earn a bonus?



Source: Annual financial statements

Source: Mergence

Preston says this is a concern as it suggests that the median CEO or performer could receive a 100% of his base salary in variable pay which raises the fear that on an aggregate level, the targets for variable pay and bonuses might not be challenging enough, as it seems relatively easy to receive variable pay.

He says while there definitely are companies in South Africa that are making inroads in constraining executive remuneration and ensuring that lower paid workers' salaries are increasing faster, there are others where the wage gap is increasing.

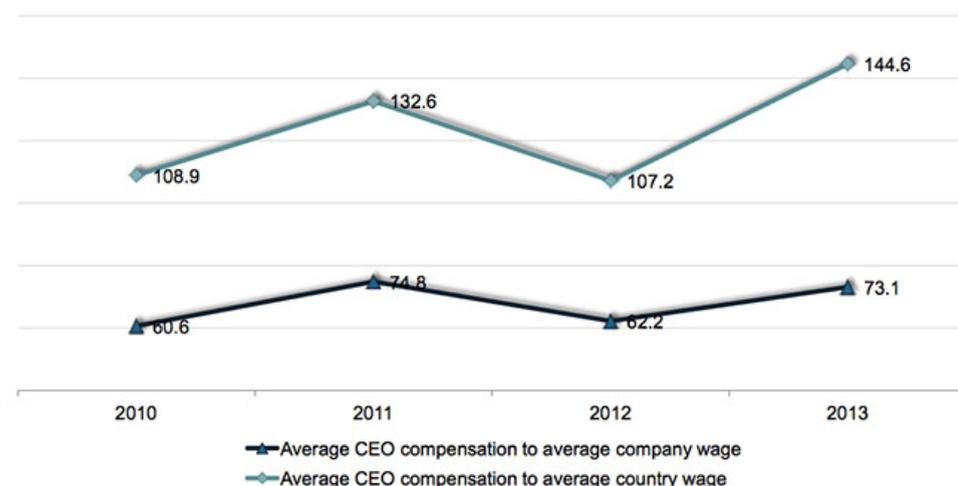
Wage gap

While there is a need to attract and retain the best international talent in order to be globally competitive, this has to be done with the necessary sensitivity for rising levels of inequality in the country, he says.

Mergence's research into remuneration practices shows an upward trend over the last five years, with the gap between CEO total compensation and average employee compensation increasing from just under 120 times in 2009 to over 140 times in 2013 (see graph). Total remuneration includes base pay, benefits, cash bonuses and share base payments.

SA Wage Gap Over Time

Movement over the past 4 years



Source: Annual financial statements, StatsSA

Source: Mergence

The trend appears to be driven by actual increases in remuneration packages rather than just variability in bonuses and share grants.

The contentious issue of executive remuneration has received increasing attention in recent months as a strike in the platinum sector enters its fifth month.

Preston says the increasing gap between executive pay and worker salaries is a global phenomenon.

While it is difficult to get consistent data based over a long period of time, Gini coefficient data from the World Bank (fourth column in table below) also highlights the high level of income inequality in South Africa.

Against this background executive remuneration is potentially more of a concern for South African listed companies than their peers because they are operating in an environment where this is a very sensitive topic and there is a much larger inequality within the society as a whole, he notes.

Global Pay Gap

How does SA compare to global peers?

	Average CEO compensation to average company wage	Average CEO compensation to average country wage	Gini coefficient
United States	164.4	331.0	45.0
Hong Kong	115.2		53.3
Germany	102.2	147.0	28.3
United Kingdom	93.2	84.0	34.0
South Africa	73.1	137.0	63.1
Malaysia	63.2		46.2
Australia	54.7	92.0	30.5
Japan	53.8	67.0	38.1
Italy	51.9		36.0
France	48.0	104.0	32.7
Switzerland	47.5	148.0	33.7
India	32.1		33.4
Norway	30.1	58.0	25.8

Source: Annual financial statements, Bloomberg, AFL-CIO, World Bank

Source: Mergence

Preston says while there isn't great disclosure and samples are therefore not entirely representative, the data highlights a general trend.

He says what is concerning is that South Africa stands out as having a larger wage gap than quite a few of its developed and developing market peers.

Topics: CHIEF EXECUTIVE OFFICER, REMUNERATION, EXECUTIVE REMUNERATION, COMPENSATION, LISTED COMPANIES, JSE, GINI COEFFICIENT, INCOME INEQUALITY, WAGE GAP, AVERAGE EMPLOYEE, RETENTION, VARIABLE PAY, BONUS, INCENTIVE

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