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A Question of Pay

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The compensation of top executives has often come under scrutiny and with it, the role of the board and shareholders in determining such pay.

In a report by *The Business Times* on 10 September 2013, the total remuneration of the top five chief executives in Singapore was found to be more than $44 million, an average of $8.8 million per CEO. In contrast, these five listed companies have a total of 38 other non-executive directors whose combined directors' fees approved at annual general meetings was under $7 million, or an average of about $180,000 per director.

It may appear ironic that the relatively small sums of the non-executive directors' fees are subject to shareholder approval at

each AGM, while the much larger sums paid to the CEOs are not. In reality, executive compensation is determined by the non-executive directors forming the Remuneration Committee of the listed company.

BACKLASH AGAINST LARGE PAY CHEQUES

Since the global financial crisis, income inequality and executive compensation has become a flashpoint. In particular, the ratio of the pay of the top executive to the average worker has been seized upon to illustrate how outrageous it has become.

According to the American Federation of Labor and Congress of Industrial Organisations, the top US CEO pay relative to the pay of the average worker has widened from 42 times in 1982 to 353 times in 2012. In response to the groundswell of protests, the Sarbanes-Oxley and the Dodd-Frank Acts laid out some rules requiring new reporting procedures and increasing the extent to which directors can be held to be personally liable for pay excesses.

In Switzerland last year, voters backed the "against corporate rip-offs" referendum. Swiss lawmakers now have to draft a law giving shareholders the right to hold a binding vote on all compensation for company executives and directors.

In Singapore, the CEO-to-worker pay ratio has also been growing but has not yet reached the US level. A study by *The Business Times* put the average CEO-to-employee pay ratio at 122 times based on the six largest listed companies in 2010.

The question increasingly being asked is: How and who should put a check on high executive compensation?

LEGAL STATUS

The current legal position is that directors' fees are subject to shareholders' approval, while executive pay is subject to directors' approval.

That's how companies are constituted and governed. Shareholders elect the directors and agree to their fees. The directors have the power and responsibility to manage the affairs of the company, including hiring, firing and compensating the management team.

An executive director, meanwhile, wears an additional hat as an employee of the company. Employment terms are contractual matters between the employee and the company, which are matters under the purview of the board.

As such, if enough shareholders are unhappy with the performance of the board, they can (in extreme cases) remove the whole board, but they cannot remove the CEO or management of the company or determine how much to pay them. Only the board has that power.

In its recent review of the Companies Act, the Steering Committee appointed by the Minister of Finance had the opportunity to change this position. However, for better or worse, the decision was made to retain the distinction between the powers of shareholders and that of the board.

MONITORING THE GAP

There are good reasons to retain this separation of powers. Directors have a fiduciary duty to make decisions in the long-term interests of the company. Shareholders owe no such duty.

There is increasing evidence that, generally, the outlook of shareholders are short-term in nature. It is not uncommon to see

shareholders attempting to hold listed companies to ransom out of their own self-interest, say, by demanding more dividends, without considering the broader and long-term cash-flow needs and other issues facing the company.

However, giving the board unfettered power to decide on executive pay may lead to the negative trends on executive pay seen in the US and Europe. Current regulations in Singapore primarily emphasise disclosure. For example, Guideline 9.2 of the 2012 Code of Corporate Governance states that "the company should fully disclose the remuneration of each individual director and the CEO on a named basis".

A step further is to get shareholders' feedback through a non-binding vote to approve executive pay packages at the general meeting. This is being legislated in a growing number of countries including Germany, Australia, the UK and the US. The aim is that the vote will be a highly influential signal to a board to not raise salaries beyond reasonable levels.

While such "say on pay" legislation has not yet arrived in Singapore, it pays for boards to be sensitive to the current environment of perceived inequality and to increase the level of monitoring and oversight on executive remuneration. And ultimately, it is the shareholders who will decide how they want to hold the board they appoint accountable. ■