

Viewpoints: should Australian companies set executive pay to a US benchmark?

Written by The Conversation

It's the time of the year when company boards and executives face their shareholders at annual general meetings. Boards will be asked to explain the pay packages of executives. Already some have been called into question.

Some Australian companies [cite the need to rely](#) on the United States as a benchmark when it comes to setting remuneration. We asked two experts to discuss the evidence for and against this idea.

Julie Walker argues that Australian companies should look to the US to set executive pay because it's an effective yardstick and helps attract overseas talent. Reza Monem argues that Australian firms operate in different conditions to those in the US, so a different measure should be applied.

Julie Walker:

The Commonwealth Bank was the latest large Australian corporate to bear the wrath of shareholder outrage about executive remuneration [when, in November, the bank's shareholders voted "no"](#) to accepting CEO Ian Narev's remuneration package.

Clearly executive pay is a controversial issue in Australia and [the two strikes legislation](#) gives shareholders a voice in this matter. But isn't it time that we used an objective and meaningful benchmark to set the pay of Australian CEOs? It could help to avoid some of the shareholder angst about pay that unfolds in every Australian reporting season.

Looking globally, and particularly at the US, to benchmark Australian CEO pay makes economic sense. [Research warns against](#) "entrenched" CEOs who are appointed from within a company and "capture" the board of directors, allowing them to effectively set their own remuneration.

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This is a particular concern in Australia where the executive labour market is small. According to an [ACSI research paper](#), which looked at CEO appointments at 50 of the largest ASX listed companies between 2003 and 2007, almost 60% of new CEO appointments were internal appointments.

Benchmarking executive pay against relevant overseas countries like the US puts these arrangements in context and gives investors an objective yardstick against which to assess the reasonableness of Australian executive pay.

Australian companies also need the capability to compete globally. Unless executive salaries are on a par with overseas competitors, there's a risk that our corporations will attract lower quality executive talent to the top jobs.

Reza Monem:

The trouble with using an external benchmark, such as US CEO pay, is there are no standards as to how objective and meaningful it can be.

First of all, CEOs are not paid for their hours. They are paid for the talent, leadership, business acumen, and strategy skills they bring to the firm.

[Extensive research suggests](#) that the drivers of CEO pay include firm size, firm complexity, profitability, firm risk, ownership concentration and governance quality. US firms are much larger than Australian firms.

Today, an average S&P 500 firm has a [market capitalisation of about US\\$36.8 billion](#). By contrast, the ASX 300 firms have an average [market capitalisation of only A\\$5.2 billion](#).

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Besides, Australia and the US vastly differ in ownership concentration and governance structure. For example, in Australia, CEOs of [small or less-profitable firms](#) are often also chairman of the company's board. In the US, it's [usually only large and more profitable firms](#) that have a CEO who is also a chairman.

Australian firms are usually less profitable compared to a typical US firm. More importantly, there is not a lot of evidence to suggest that the US CEO pay structure is best practice in the world. The US has its fair share of controversy over CEO pay.

Moreover, using an external benchmark is not going to solve the CEO entrenchment problem. How a CEO behaves is a complex mix of variables, including their personal and professional goals, their bargaining power, the regulatory environment, ownership structure and internal governance of the company they work in. A CEO who delivers performance surely would demand greater control of the firm.

Yes, Australian firms need to compete globally and they need to attract talented CEOs. But talent is only a single component of CEO pay. It's not in the interests of anyone for a firm to pay its CEO beyond the firm's means.

Julie Walker:

Benchmarking Australian CEO pay against their US counterparts will not necessarily lead to higher remuneration for Australian executives. Benchmarking is a comparative process and, as Reza points out, there are good reasons why some CEOs are paid more than others (firm size, complexity, profitability).

These reasons can and should be factored into the comparison. Many Australian corporations already track counterpart companies' performance, as a basis for performance based remuneration. Benchmarking to US executive salaries is just another small step and completely consistent with current remuneration practice.

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If Australian business wants talented, innovative business leaders, then the remuneration offered must be sufficiently attractive to retain and reward the individuals concerned.

If Australian investors want more assurance that CEO remuneration packages are commensurate with remuneration offered overseas, then benchmarking against US executive remuneration will help to provide that assurance.

Reza Monem:

If Australian CEOs were under-paid, we would have seen our top CEOs going overseas and taking leadership of larger, better firms. Australia would have been a country that exports CEOs.

But statistics show quite the contrary. In ASX 200 firms, 80% of the CEOs [are either born or educated overseas](#).
So we import talent.

Tracking counterpart firms' performance might be a good idea in setting CEO pay, but if the counterpart firm operates in a different market where the institutional environment is different, then finding the right firm to compare with might be elusive.

This is where the problem lies. If a firm wishes to find a counterpart, ideally it should find one within the same market and within the same industry. To what extent the US market for executives is similar or comparable to the Australian market is really the big question.

Reza Monem is affiliated with "Reflections on Development and Governance", an independent think tank.

Julie Walker does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations

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beyond the academic appointment above.

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