Is capping CEO compensation a good idea?

Peter Drucker, the management Guru opined that a CEOs salary should not be more than 20 times that of the average company worker, else the company will see middle management morale erosion. Last month, Switzerland voted on the idea 'Should a CEO salary should be capped at 12 times the average company workers salary?'. The Swiss citizens voted against capping CEO salary, as it would hurt long term Swiss competitiveness!

The attached table from Executive Paywatch gives the ratio of CEO salary to worker salary in 2012 for a few countries. The ratio is way off Drucker's recommendation of 20. The Indian data is not available. An educated guess points to a ratio of 20 in small Indian companies, 75 to 100 in midsize and government companies, 500 or more in large Indian firms. Two thirds of the Dalal street companies are family concerns, and a family CEO is different from a multinational firm CEO on salary. That nuance must be considered.

Country	2012 CEO Salary $ Mln	2012 Avg.Worker salary, 000$	Ratio CEO salary to Worker salary
USA	12.2	34	354
CANADA	8.7	42	206
SWITZERLAND	7.4	50	148
GERMANY	5.9	40	147
FRANCE	3.9	38	104
AUSTRALIA	4.2	44	93
SWEDEN	3.3	37	89
UK	3.7	44	84
JAPAN	2.3	35	67
NORWAY	2.5	43	58
PORTUGAL	1.2	22	53
POLAND	0.56	20	28

Why have CEO salaries ballooned and why are they under scrutiny?

CEO salaries have ballooned in the last twenty years as services grew and the global talent market thronged services like banking, financial services and consulting. Consulting

firms and investment bankers absorb two thirds of Harvard MBAs. The next reason is Star CEOs, bigger brands than the company they lead! With globalization, companies developed regional hubs in Hong Kong, Singapore, Dubai, London, New york, and Rio de Janeiro. This set up a glocal manager, paid in dollar equivalent and he in turn pushed up salaries above him. The Private Equity firm has stepped in with extra large salaries and promised pay outs for meeting valuation targets and this is a new salary benchmark. Finally,the idea of rewarding CEOs with stock options for better alignment.

Stock options act to align CEO actions with shareholder interests. When the share price goes up, the CEO gains, when the share price tanks, the investor loses and this win-win for the CEO is unpalatable to shareholders.

The scrutiny is due to the excesses of 2008 and celebrated examples. Daniel Vassella, the outgoing Novartis CEO was paid $78 Mln to dissuade him from joining competition. Shareholders protested and finally a tenth of this amount was paid. Bob Nardelli refused to

discuss his package of $140 million and was forced out of Home Depot. The device CEOs of Motorola, Nokia and Blackberry were paid high bonuses for creating value by selling their companies! This upset shareholders. These high salaries were unpalatable in America, Europe, and Japan, all going through layoffs and high youth unemployment. The SEC wants the ratio of CEO salary to median pay of all employees reported in a company's results so that investors know the salary disparity in the company. Once they know it, they expect to do something.

So, what is a good CEO salary? There is a war for talent, every company wants good people. The CEO can do little on his own, he is the inspiration with substance who should orchestrate company results. Then there is the risk with the CEO job. Forty per cent of American CEOs don't last two years on the job. The average CEO tenure in India is around four years. Rarely do CEOs have a second life because the analysts and the media bury them for the first perceived mistake they make. There is relentless scrutiny of every statement and action of a CEO. Not many can handle that

relentless pressure. The CEO and the company pay differently for this pressure.

There is growing talk of responsible capitalism and long-term focus. In the 1970s, long-term capital investment to shareholder disbursement was 15 to 1. Today it is 2 to 1. Few companies and CEOs think long term. Responsible capitalism is a commitment to the community, society and a resource challenged globe. The compensation committee in every board will be challenged about responsible remuneration in the future. The high CEO salary is a carrot for better results. Do companies with lower ratios produce better results because of stronger affiliation, trust, engagement with the leader? There is no evidence to prove that today.

Traditional capitalistic societies like the US deal with this better. Former communist countries and socialist countries find this new CEO compensation hard to manage. Who will justify CEO compensation in the days ahead?