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Cult of excess? A global perspective on CEO compensation

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Many argue that Australian executives are overpaid. The Australian Financial Review recently quoted Prime Minister Malcolm Turnbull claiming a "cult of excessive executive CEO remuneration". [1] Similarly, Fairfax Media reported Peter Morgan's view that Australian CEOs are 25 percent to 50 percent overpaid. [2] Heavyweight fund manager AMP Capital has also expressed concern over the level of pay.[3]

However, reducing remuneration may curtail Australia's access to high-quality managers from across the globe. AMP Capital sympathises with the view that global benchmarking is a highly relevant input in compensation-setting. Further, Professor Peter Swan of UNSW suggests that some tolerance of inequality may be beneficial, as further stretching CEO compensation can enable the development of a superior talent pool.[4]

To provide some preliminary evidence on the issue of CEO remuneration, we examine the CEO pay of leading Australian companies and compare with that of comparative CEOs globally. We focus on the compensation packages of CEOs from four significant Australian firms: Macquarie Group, Commonwealth Bank, CSL, and Woolworths Group. We choose these firms because of their prominence and their high level of CEO compensation of relative to other Australian firms. Further, Commonwealth Bank and CSL have registered strikes against their remuneration reports in recent years, and Woolworths and Macquarie have been reported to have key shareholders or proxy advisers threaten future dissent.[5] Thus, all four firms may be likely candidates for excessive remuneration.

For each firm, we construct a peer group of five global firms drawn from the same industry and from comparable developed economies.[6] We compare the levels of compensation for each CEO of the four Australian firms with the reported compensation of the CEOs of the identified peer firms.

Macquarie Group

Macquarie's executives are counted amongst the country's most well-remunerated, leading some to brand Macquarie Group as the "millionaire factory". Nicholas Moore, who became CEO in 2008 after 22 years of service, ranks amongst Australia's highest-paid.

Moore is considered to have been a fundamental driver of Macquarie's transformation from a traditional investment bank to a global banking and fund manager.[7] Macquarie's stock price has increased over 500 percent since Moore became CEO.

Nevertheless, the firm's remuneration policies have drawn the ire of both investors and analysts. Research from UBS has criticised Macquarie for maintaining investment banking compensation structures despite investment banking providing just 20 percent of earnings. [8] Investors have also expressed concern about remuneration practices, with 15 percent voting against the 2017 remuneration report. While not sufficient to register a "strike" against the report, the Australian Shareholder Association has cautioned that it may vote against future remuneration arrangements unless Macquarie improves disclosure and addresses level of pay and target-setting concerns.[9]

In the 2017 fiscal year, Moore received $18.7 million in compensation, far in excess of the remuneration given to CEOs of the Big 4 Australian banks. Moore's compensation was in line with that of the prior year and represents steady growth from $13.1 million in 2014. Macquarie has performed at the top of its nominated peer group, with continued improvement in profitability leading to substantial performance-based compensation.

In Exhibit 1, we compare Moore's compensation to a range of matched investment banking peers. Despite criticism of the quantum of Moore's compensation, there is little evidence to suggest Moore is overpaid relative to global CEO peers. Moore's pay, while high, is in keeping with the industry. Two Swiss firms provide useful peers for comparative analysis: Credit Suisse Group, with CEO Tidjane Thiam earning $16.2 million; and UBS Group, with CEO Sergio Ermotti earning $18.7 million. In both cases, Moore's apparently outsized compensation is consistent with Macquarie's superior performance in terms of both return on equity (ROE) and total shareholder return (TSR), resulting in greater long-term incentive plan awards for Moore than for either Swiss banker.[10]

Traditional investment banks Goldman Sachs and Morgan Stanley provide just under 50 percent higher pay to their CEOs, with Australian born James Gorman of Morgan Stanley of similar age and background to Moore. Finally, Bank of New York Mellon's Gerald Hassell runs an organization twice the value of Macquarie Group, and earns an additional $6.2 million compensation.

Collectively, there is little evidence to suggest that Moore is excessively paid. Based on our evidence, the firm's superior performance and ongoing growth may appear to justify shareholder value from Moore's remuneration.

Commonwealth Bank

In 2017, Commonwealth Bank CEO Ian Narev drew considerable criticism for the level of his compensation in the wake of numerous scandals troubling his firm. This led to an unprecedented decline in Narev's compensation to 2012 levels. In 2017, Narev received $5.7 million, compared to $8.8 million in 2016. This reduction resulted in part from forgoing all short-term incentive payments Narev may otherwise have been eligible for.

Exhibit 2 compares the Commonwealth Bank CEO's compensation to global retail banking peers. Narev's pay appears well below global market norms. US Bancorp and BNP Paribas provide the closest size-matched peers, the former paying CEO Andrew Cecere $20.0 million, while BNP CEO Jean-Laurent Bonnafé received $4.9 million. The US bank provides the most comparable data point, with both US Bancorp (14.1 percent) and Commonwealth Bank (15.7 percent) ranking amongst the highest performing retail banks in the world on an ROE basis, with both well above the European peers.

There is little evidence to conclude that the Australian market was paying premium compensation to Narev relative to global benchmarks. Even in fiscal 2016, Narev's $8.3 million in compensation was also considerably lower than US Bancorp and most other peers, suggesting that the negative publicity received by the CEO and the bank in 2017 does not explain the comparatively low pay.[11] Further, incoming CEO Matt Comyn will assume the helm of the bank with $2.20 million in base salary and a potential $6.16 million in bonuses. Comyn's compensation arguably remains below well-performing foreign banks, providing little evidence of a "cult of excessive executive CEO remuneration".

CSL

CSL is one of the most blue-chip Australian firms to earn a strike against their remuneration report in recent years. CSL is a global business, generating less than 10 percent of its revenue in Australia, and more than 40 percent in the US. Yet investors have expressed concerns regarding the use of US-style compensation practices and performance metrics, such as TSR. Over 25 percent of shareholders voted against the remuneration report in 2016, with strong dissent from institutional shareholders, and CSL only narrowly escaped a second strike by implementing changes to compensation methods and disclosures.

Exhibit 3 compares the remuneration of CSL's CEO Paul Perreault with that of his global biotechnology peers. Even though Perreault's compensation has risen 170 percent from 2013 to 2017, at $10.7 million, it is lower than that of both Perreault's predecessor, Brian McNamee, and his global peers. While CSL is comparable in terms of size and performance to US peers Abbott Laboratories and Regeneron Pharmaceuticals, both US CEOs earn considerably more. Miles D. White of Abbott Laboratories was paid $26.4 million, and Leonard Schleifer of Regeneron earned $36.9 million.[12] Both data points suggest Perreault may be more paid below what he might earn in a truly global labour. Smaller peers also provide little evidence that Perreault is awarded competitive compensation. In 2016, US firm Zoetis and UK firm Actelion provided CEOs with compensation similar to Perreault's, despite both firms being considerably smaller and less profitable.

While institutional investors may continue to pressure CSL's board to improve compensation disclosures and ensure that performance targets adequately motivate Perreault, it is more difficult to see reasons for concern over the quantum of compensation. Indeed, GlaxoSmithKlein notes in its annual report that now ex-CEO Sir Andrew Witty's remuneration of $11.6 million was among the lowest in the world for its peer group, suggesting that Perreault's compensation of $10.7 million may be a relative bargain for shareholders.

Woolworths

Woolworths Group has drawn very little criticism for compensation package of new chief executive Bradford Banducci, a supermarket veteran who assumed the helm of Woolworths in 2016.[13] In 2015, shareholders had been "angry" about a 45 percent reduction in Woolworths valuation and the exit package for departing CEO, Grant O'Brien.[14] Nonetheless shareholder dissent (9.3%) fell far short of the 25% required for a strike against the remuneration report.[15]

Woolworths is amongst the largest supermarket-based retailers in the world. However, Banducci is amongst the lowest-paid of his class. Exhibit 4 compares Banducci's compensation of $4.0 million with that of grocery retail peers. French supermarket chain Carrefour SA provides the most meaningful comparison, with CEO Alexandre Bompard earning $9.7 million. well above Banducci's. Given the size and profitability of Woolworths, Bompard's compensation appears proportionate to Banducci's equity grant-inclusive compensation of $11.0 million. Further, comparison with similar-sized supermarket chains also suggest Banducci is relatively underpaid, with Kroger's CEO Rodney McMullen receiving $17.2 million in compensation, and Tesco CEO Dave Lewis receiving $12.1 million.

Insights

From a limited sample, we find little evidence that CEOs of these large Australian firms are excessively compensated when benchmarked against global peers. These preliminary findings are not consistent with an alleged "cult of excessive executive CEO remuneration". We are currently working on an *Insights Series* piece that provides a more comprehensive analysis of compensation of Australian CEOs relative to their global peers.

These findings raise important questions. First, do the apparently *relatively* modest levels of CEO compensation suggest that shareholders of Australian firms should be satisfied with CEO remuneration practices? In a forthcoming *Insights Series,* "Say on Pay: Some Observations", we argue that the answer is not obvious.

Second, is paying CEOs of Australian firms less than their global peers consistent Australian firms successfully competing in the global market for CEO talent? In our companion *Insights Series* piece "CEO talent: Where do Australia's CEOs come from?", we find that few CEOs in Australia are recruited from abroad. This fact does seem consistent with pay levels for Australian CEOs not needing to be in line with global benchmarks. Further research is needed to understand whether this is optimal for Australian firms.

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The ***Insights Series*** is a collection of short studies exploring contemporary issues and best practice in corporate governance, produced by the Melbourne Centre for Corporate Governance and Regulation (MCCGR) at the University of Melbourne. For more information, visit: go.unimelb.edu.au/b9t6.

Exhibits

Dollar amounts in $A millions.

Exhibit 1: Macquarie Peer Group

Company	Year	Compensation	Market Cap	ROE	TSR
Macquarie Group	2016	18.7	30,700	14.25 %	44.56 %
Morgan Stanley	2016	27.8	102,632	8.72 %	36.06 %
Goldman Sachs Group Inc	2016	26.5	130,243	9.77 %	34.91 %
Bank of New York Mellon Corp	2016	25.1	65,080	10.06 %	17.04 %
Credit Suisse Group	2017	15.6	58,273	-2.35 %	29.20 %
UBS Group AG	2017	18.0	90,562	2.27 %	16.45 %
Peer mean		22.6	89,358	5.7 %	26.73 %

Exhibit 2: Commonwealth Bank Peer Group

Company	Year	Compensation	Market Cap	ROE	TSR
Commonwealth Bank of Australia	2017	5.7	143,251	15.72 %	17.41 %
PNC Financial Services Group Inc	2016	17.1	73,942	9.35 %	25.78 %
US Bancorp	2016	20.0	113,626	14.09 %	23.40 %
HSBC Holdings plc	2016	7.4	220,947	1.57 %	32.11 %
BNP Paribas	2017	4.9	115,553	7.61 %	7.17 %
Lloyds Banking Group plc	2016	9.6	75,539	4.99 %	–10.45 %
Peer mean		11.8	119,921	7.52 %	15.6 %

Exhibit 3: CSL Peer Group

Company	Year	Compensation	Market Cap	Profit	TSR
CSL Ltd	2017	10.7	62,640	1,744	24.97 %
Zoetis Inc	2016	12.3	34,390	1,071	12.64 %
Regeneron Pharmaceuticals	2016	36.9	50,725	1,168	–32.38 %
Abbott Laboratories	2016	26.4	73,743	1,386	–12.32 %
GlaxoSmithKline plc	2017	11.6	111,014	2,594	–10.78 %
Actelion Ltd	2016	9.7	32,340	948	59.48 %
Peer mean		19.4	60,442	1,433	3.33 %

Exhibit 4: Woolworths Peer Group

Company	Year	Compensation	Market Cap	Profit	TSR
Woolworths Group Ltd	2017	4.0	33,060	1,423	25.65 %
Kroger Co	2016	17.2	40,903	2,575	–11.33 %
J Sainsbury plc	2016	4.0	9,786	639	0.22 %
Tesco plc	2016	12.1	26,077	122	2.31 %
Wm Morrison Supermarkets	2016	4.7	9,336	517	38.84 %
Carrefour SA	2016	10.3	25,739	1,169	–11.56 %
Peer mean		9.7	22,368	1,004	3.69 %

Notes:
Data from Computstat/Capital IQ and Execucomp and firm annual reports. ROE and profit figures exclude the effect of special items. Where applicable, compensation and financial measures have been adjusted for currency exchange rates at the balance date of the Australian subject firm. Compensation is as tabulated in regulatory filings. Peer firms are identified using the following criteria:

Macquarie Group:	SIC codes 6020, 6199 and 6211. Matched on market capitalisation.
Commonwealth Bank:	SIC code 6020. Matched on market capitalisation.
CSL:	SIC codes 8731 and 2830–2839. Matched on market capitalisation and profit before extraordinary items. Excludes matches with Estee Lauder, Ecolab and LyondellBasell NV.
Woolworths:	SIC codes 5399 and 5410–5419. Matched on market capitalisation. Excludes match with Whole Foods Market.

[1] Australian Financial Review, “CEOs pay a ‘cult of excess’: Malcolm Turnbull, February 2017.
[2] Australian Financial Review, “CEOs pay a ‘cult of excess’: Malcolm Turnbull, February 2017; Sydney Morning Herald, “Pay bonanza continues for Australia's CEOs, despite some nips and tucks”, September 2017.
[3] AMP Capital, “CEO pay: What are CEOs worth?”, April 2016.
[4] Swan, Peter. “CEO pay study shows how much Australians tolerate inequality”, September 2014.
[5] Australian Financial Review, “Macquarie Group’s investors fire warning shot over pay disclosures”, July 2017.
[6] We focus on the United States, United Kingdom, New Zealand, Canada, France, Germany and Switzerland and define industries using standard industry classification (SIC) codes.
[7] Australian Financial Review, “True Leaders 2015: Macquarie’s Nicholas Moore ‘great success’ story”, August 2015.
[8] ABC News, “Macquarie Group pays its staff too much, says rival investment bank UBS”, March 2015.
[9] Australian Financial Review, “Macquarie Group’s investors fire warning shot over pay disclosures”, July 2017.
[10] Note that Macquarie Group does not use TSR in the calculation of either short- or long-term incentive compensation. We reference TSR as a measure of value creation for shareholders.
[11] In 2016, Ian Narev’s realised compensation reached $12.3 million. Accounting for the average of banking institutions with market values both above and below that of Commonwealth Bank, this compensation is not significantly out of line with the mean compensation in the peer group of $11.8m.
[12] In 2016, reported compensation for Miles D. White significantly exceeded total direct compensation due to $5.0 million of non-direct remuneration benefits.
[13] Banducci received $6.5 million in equity compensation in fiscal 2017, which would increase reported compensation to $11.0 million.
[14] Sydney Morning Herald, “Woolworths under new pressure over CEO’s ‘pay-for-failure’ exit package”, November 2015.
[15] Macquarie Group does not use TSR in the calculation of either short- or long-term incentive compensation. We reference TSR as a measure of value creation for shareholders.