No value in empty gestures

Income disparity is one of our society's most serious challenges. But measures like the CEO pay-ratio rule recently approved by the SEC aren't needed and won't do anything to address the problem

By Ken Hugessen with Allison Lockett

The SEC in the U.S. recently announced that it is moving ahead with the CEO pay-ratio rule contained in the *Dodd-Frank* bill. That rule requires public companies to calculate and disclose the ratio of the CEO's pay to that of the median pay employee (the employee who has the same number of people earning more and earning less than him/her).

There's little doubt that this rule, once implemented, will become a highly visible reminder of one of our society's most serious chal-lenges—income disparity. When those ratios of CEO pay to median worker are disclosed, expect them to frequently range to 300 and 400 or more.

But what's doubtful is that the CEO pay-ratio rule will do anything to address that disparity. What's more, boards don't need another rule—they already have the tools they need to manage CEO pay, including, most importantly, ensuring its alignment with performance.

There is widespread recognition today that income disparity is a major and worsening problem, one that has the potential to seriously damage social cohesion and broad public support for our much cherished, free-market economies.

But is CEO pay at publicly traded corporations a significant contributor to income disparity? Or is income disparity in a corporation simply corporations responding to the environment in which they operate?

To begin with, CEOs are actually only a small part of the 1%, or .1%, or .01% groups, which are made up of professionals (doctors, investment bankers, lawyers), entertainers, entrepreneurs, inheritance—by most estimates, CEOs are about 15% of the .01%—and none of the very wealthiest.

Secondly, even if you were to redistribute most of a CEO's pay among other employees of the company, you'd find it would have a negligible effect on their incomes. Look, for example, at Walmart—if you took half of the CEO's pay of $20.7 million (in 2013) and allocated that $10.4 million over Walmart's approximate 2.2 million employees, it would give them each a raise of approximately $4.70 a year, or 20¢ per paycheque.

Shareholders and boards, on the other hand, should care about CEO pay—not solely because of its size, but rather when it fails to respond (e.g. to go down) to poor performance, effectively indemnifying the CEO from the weak performance he/she is supposed to be accountable for, and suggesting that poor performance is somehow acceptable to the board.

Photograph: Jeff Kirk

The good news here is that boards already have the tools they need to monitor and adjust CEO pay—they simply need to use them, as follows.

- Splitting the role of CEO and chairman of the board is a useful first step to prevent a CEO from acting as both player and referee of his/her own performance and pay. This move is still work in progress in the U.S., but the endgame seems pretty clear.
- Pay surveys, that once arguably fueled pay increases, are today as likely to be used by directors, responding to shareholder pressure, to constrain CEO pay.
- Say-on-pay, now mandatory in the U.S. and widely offered by Canada's large issuers, provides shareholders with a strong tool of moral suasion and public embarrassment (Barrick's say-on-pay result earlier this year, for example, in which it received just 15% support, sent its directors an unambiguous message).

Shareholders and boards should care about CEO pay—not solely because of its size, but rather when it fails to go down due to poor performance, effectively indemnifying the CEO from the failure he/she is supposed to be accountable for.

- Finally, and perhaps most importantly, majority voting provides shareholders the ability to remove a director, or an entire compensation committee or board, if they so choose. To date, we have seen relatively few directors voted off of boards, but it is high-risk behaviour for directors not to take heed of poor say-on-pay results as a forerunner for majority voting results.

As for the CEO pay-ratio rule? It may offer hardcore pay critics a few feel-good moments, but if we are truly interested in doing something about income disparity, pointing to CEO pay practices as a solution is an empty gesture.

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