International executive pay: current practices and future trends*

Randall S. Thomas

1 Introduction

International executive compensation practices over the past 30 years can be classified in a dualistic manner: American pay systems versus those in the rest of the world. The US remuneration approach for top executives is characterized by highly incentivized and lucrative compensation arrangements (Cheffi ns and Thomas 2003; Cheffi ns and Thomas 2004). The size of these payments has made American CEO pay highly controversial. On the positive side, many commentators, including Murphy (1998, pp. 2551–5) believe that option-filled pay packages fulfill a useful function by aligning the interests of shareholders and executives, and that the higher risk levels associated with large option holdings justify bigger amounts of pay. Critics, however, such as Bebchuk and Fried (2004), claim that US CEO compensation is the product of self-serving managerial ‘rent extraction’, with captured boards of directors paying out ridiculous amounts to self-interested CEOs (but see Core et al. 2005). In other parts of the world, CEO pay levels have been lower, bonus payments smaller and their remuneration packets have contained fewer, if any, stock options.

As Cheffi ns and Thomas (2003) have noted, in recent years, a potential trend has arisen toward merging these two pay structures in a global pay regime. However, no consensus exists as to whether this convergence is taking place and some observers, including Stabile (2001a), believe that the divergence between the US and other countries will persist and may even widen.

This chapter asks if we are seeing a possible convergence trend on the executive pay front.1 After surveying American and foreign pay practices, it considers the various factors that could be leading toward, or away from,

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1 There are conflicting views on this question. For a view that convergence is occurring, see Johnston (1998) (quoting Professor Kevin Murphy). For an opposing view, see Gross and Wingerup (1999).
global pay integration. While it is difficult to predict how important each factor will be, the effects of market forces, as well as other variables, such as legal regulation and business culture, will be explored fully.

The chapter is organized as follows. Section 2 gives an overview of US pay practices, while Section 3 discusses CEO arrangements in other countries. Section 4 discusses market-oriented factors that could affect the convergence of executive pay practices. In the sections following, I consider how global pay practices could be affected by legal regulation, soft law and national culture. A brief conclusion follows.

2 US pay practices
No one disputes that American CEOs are better paid than their foreign counterparts, both in terms of overall pay levels and in terms of the incentives in the pay arrangements. To understand why this is the case, it is first important to understand the basics of executive pay (Hallock and Murphy 1999). (For more extensive discussion in this vein, see Murphy 1998; Sirkin and Cagney 1996; Wolf 2000; Milgrom and Roberts 1992). There are four primary components of international and US executives’ pay packages: base salary, annual bonus, stock options and long-term incentive pay. Base salaries are a fixed amount that is paid to the executive independent of the firm’s performance. All of the remaining elements of CEO pay depend on firm performance either directly or indirectly. The first main form of variable performance-based pay is the annual bonus. Annual bonuses are typically cash payments awarded when a company has met specified yearly share price or accounting targets. (For an article discussing the nature of annual bonus plans, see Chingos 1999). A second form of incentive pay is the stock option. Stock option grants give managers the right to buy shares from their company at a prescribed exercise price after a vesting period that typically lasts several years. The last important category of incentive-based pay is long-term incentive plans (LTIPs). These are generally bonus payments that are calculated on performance variables measured over a period of several years. Instead of cash, LTIPs often award executives ‘restricted stock’ (that is, equity that cannot be sold for a specified number of years) or units under a performance scheme that allows them to receive financial benefits akin to owning equity without actually giving them shares (for example, ‘phantom stock’ or ‘stock appreciation rights’). As we will see, the amounts of each form of pay, and the composition of its variable components, vary widely across countries.

A High pay for performance levels
American chief executives receive much of their compensation in the form of variable payments that are only made if their company meets or exceeds prescribed targets. For example, Conyon and Murphy (2000) surveyed
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1997 pay arrangements in over 1,600 publicly traded American corporations and found that the typical US CEO received 29 percent of his or her overall annual compensation as base salary and 63 percent in variable pay. They noted that stock option grants were the most important type of incentive pay, at 42 percent of total compensation. According to Conyon and Murphy, annual bonuses comprise 17 percent of total compensation. Finally, they noted that LTIPs composed 4 percent of the compensation of a typical American CEO of a publicly quoted company.


Figure 7.1 Total remuneration – Chief Executive Officer

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2 For more recent figures, see Lublin (2007) (indicating that 185 US executives exercised options for a median gain of $3,229,193 in 2006).
Stock options’ importance in US CEO compensation packages is a relatively recent phenomenon (Hall and Liebman 1998). Over the 1990s, ‘stock options rose from five percent of shares outstanding at major US companies to fifteen percent – a three hundred percent increase’ (Coffee 2002). In 1980, CEOs’ salary and annual bonus averaged $655,000, while their stock option grants averaged $155,000 (both in 1994 dollars). Fourteen years later, CEOs’ salary and bonus averaged $1,293,000, a rise of 97 percent. However, during the same time period, stock option grant values grew by 683 percent, to an average of $1,213,000. Moreover, the overall percentage of CEOs receiving stock option awards increased from 30 percent to nearly 70 percent. This trend has continued as stock options continued to grow in importance for American CEOs after 1994. However, US companies ‘have increased their use of restricted stock and performance shares, and are likely to [continue] to do so in the future . . .’, because of the Financial Accounting Standards Board’s (FASB’s) decision to require expensing of stock options (Towers Perrin 2005a). In fact, in 2007, ‘performance-based plans overtook stock options as the most popular form of long-term incentive compensation’ (Hay Group 2008).

B High compensation levels
CEO pay in the US is substantial. According to Towers Perrin’s most recent comparative study of worldwide CEO compensation, using as a benchmark locally headquartered industrial companies with approximately $500 million in annual sales, US CEO total annual pay was $2,164,952 in 2005 (Towers Perrin 2006). Figure 7.1 displays this data. Base salary made up about 27 percent of this total, while total variable pay (mostly long-term incentive pay) accounted for another 62 percent. Annual data for the largest US firms shows much higher values. For example, in 1997, the average total compensation for CEOs at large companies was $5.9 million (Conyon and Murphy 2000). Figure 7.2 illustrates this data.

Other estimates of US CEO remuneration vary according to the type of pay being reported and the size of the companies that are being surveyed. For example, focusing solely on cash compensation, in 2005, large US firms paid their CEOs a median cash compensation of $1,865,000 (Wall Street Journal 2007, CEO Compensation Survey). However, if we look at total pay, then in 2007, the median pay of CEOs of S&P 500 companies was $8.8 million (Burr 2008). Any way that the data are cut though, these values are much larger than those observed in the rest of the world.

3 CEO pay in other countries
US CEOs’ pay arrangements are distinctive by international standards. Outside the US, CEOs receive less performance-oriented pay as a
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Figure 7.2 Pay components 2005 – Chief Executive Officer (as a percentage of total remuneration)
percentage of their total pay and overall executive compensation packages are not as large. Over time, however, there is some evidence of a shift towards American compensation patterns.

A Lower levels of performance-based pay than in the US

CEO remuneration is less highly incentivized outside the US. This difference is reflected in the relatively smaller amount of variable pay in other nations. The Towers Perrin (2006) survey on worldwide executive compensation cited above indicates that at locally headquartered companies with annual sales of $500 million, total variable pay for US CEOs averages 62 percent of their total pay. This figure exceeds that for all of the other 25 major countries surveyed in this study. The Towers Perrin (2006) breakdown of variable pay into its components of annual bonuses and long-term incentive pay shows that American CEOs are paid far more in stock options than foreign CEOs, although Towers Perrin (2005a) reports that a slightly higher percentage of French companies award options. Figure 7.3 displays this data.

The Towers Perrin data also show that long-term incentive pay is becoming more important in many other countries. While annual bonuses were part of the compensation package of chief executives in all of the countries surveyed, incentive schemes designed to operate over a longer period were not as common, although they are becoming more important since 1998. For example, in the Towers Perrin (2001) survey conducted in 2000, of the 26 jurisdictions covered, chief executives in seven of these were not beneficiaries under a long-term incentive plan. The most recent Towers Perrin (2006) survey using 2005 data shows that only in India did the average CEO have no long-term incentive pay plan. Overall, long-term incentive plans are ‘now prevalent in most countries’ (Towers Perrin 2005a).

At a more detailed level, a quick comparison of the US with two developed and two developing economies illustrates these points. First, consider Sweden and Germany, two highly developed European countries. The Towers Perrin data show that the total average CEO pay package in 2005 at comparable Swedish firms was $948,990, or about 44 percent of the American CEO. Towers Perrin (2006) found that the pay structure at Swedish corporations is still heavily skewed toward salary, bonus and company contributions to government social programs or voluntary company-sponsored plans. They also found that long-term incentive pay, including stock options, stock grants and other long-term pay, comprises 8.4 percent of total pay. They report that total variable pay, covering bonuses and long-term incentive pay, is only 18 percent of CEO pay.

German CEOs at similar sized firms earned $1,181,292 in 2005, according
to Towers Perrin (2006). They report that stock options and long-term incentive pay comprised only 18.5 percent of total pay at these firms. However, they found that discretionary bonuses were quite important at German firms, comprising 33 percent of overall CEO remuneration. Prior to 1 May 1998, German corporations were not permitted to issue stock options unless they were based on convertible bonds. However, even those convertible bonds options were often challenged by shareholders in German courts. Therefore only a few of the largest German companies granted those options before May 1998. After May 1998, stock option plans became more common. An estimate is that nearly 70 out of the 100
major stock corporations in Germany have established stock option plans for middle and upper management.

Two very important emerging economies are China and India. CEO pay levels and composition in these nations are quite different from their developed country counterparts. According to Towers Perrin (2006), in 2005 a typical Chinese CEO located in Shanghai received $211,255 in total compensation. Their pay is composed of 37 percent salary, and 56 percent total variable pay, almost all of which is in the form of long-term incentives. Stock options are a far less important source of income for Chinese executives (Firth et al. 2007). According to Kato and Long (2005), this is largely because they were prohibited in China until 2003, when for the first time the Chinese Securities Regulatory Commission (CSRC) permitted two firms to create stock option plans.

Hong Kong, while distinct from the remainder of China for many historical reasons, is a second potential comparison point for Chinese executive compensation. Towers Perrin (2006) reports that the comparable 2005 figure for CEO total remuneration for CEOs of Hong Kong-based Chinese firms is $651,339, with 28 percent in variable pay and 7.5 percent in long-term incentives. A subsequent study by Towers Perrin (2007) found that more than 70 percent of Red Chip firms (firms from the People’s Republic of China that are incorporated and listed in Hong Kong) and other Hong Kong-listed companies had stock option plans in 2004. Moreover, there is an upward trend in the use of stock options with 77 percent of Red Chip firms granting stock options in 2007 (Watson Wyatt 2007).

Indian CEO pay is more like that of Chinese CEOs in Shanghai: Towers Perrin (2006) states that 2005 average total pay is $290,854, which was 45 percent base pay, 33 percent perquisites and only 14 percent variable pay. Riding high on a booming stock market in recent years, Indian companies have adopted equity-based compensation to retain top talent. In a recent survey of Indian companies, 64 percent offered long-term incentives, out of which 68 percent say stock options are their preferred form for such pay

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3 Recent research suggests that top management remuneration in China is much lower than indicated by Towers Perrin’s data. This research finds that the median compensation for the three highest paid executive directors at Chinese companies is ¥106,667, which is roughly $13,333 at the prevailing exchange rates Firth et al. (2007, p. 14). One probable explanation for this dramatic discrepancy is that Firth et al. took account only of salary and bonus, while the Towers Perrin data include salary, variable pay (including bonus and long-term incentives), benefits and perquisites. A second possible explanation for the differences is that Firth et al., used a much broader sample of firms and average firm size may have been smaller than for the Towers Perrin sample.
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(Hewitt Associates 2007). Despite these plans’ popularity, India still lags far behind the US and many of its developed country counterparts in the use of equity-linked incentives.

B Lower CEO pay outside the US

Historically, at least since the early 1960s, American chief executives have been paid more than their counterparts elsewhere (Abowd and Kaplan 1999; Paton 1962; Vagts 1983). Overall, foreign CEOs receive less of their total pay in the form of variable compensation. However, they also get significantly less total pay than their American counterparts. According to Towers Perrin (2006), total annual remuneration for a US chief executive in 2005 was $2,164,952. The closest country was Switzerland, where CEOs earned $1,390,899, or less than 65 percent of what US CEOs earned. They found that only four other countries exceed 50 percent of American CEOs’ total pay (France, Germany, Italy, and the UK). For all 20 of the other countries they surveyed, the US values were more than double the average pay for CEOs.

The pay disparity between the US and other countries may be larger than the Towers Perrin data suggests. For example, Conyon and Murphy (2000) compared UK and US CEOs’ remuneration in 1997, finding that American median total compensation of $2.4 million was 260 percent more than the median British pay. The gap was even greater for average compensation, with the US figure of $5.9 million being 500 percent more than the comparable UK figure. However, more recent data from a study by Conyon et al. (2006) show that the pay gap between US and UK CEOs had significantly narrowed by 2003, with the smaller differential resulting from rapid increases in UK pay and incentives versus relatively flat US CEO pay over that time period.

Another way of examining the problem is to look at CEO compensation at the very largest firms across countries. In this regard, consider the data in Table 7.1, which reports executive compensation levels for 30 of the largest publicly listed German firms, the DAX 30, in 2006.

These values are for the largest publicly traded German firms, and therefore are not comparable with the Towers Perrin data because they are not adjusted for firm size. The column labelled ‘Basic Salary’ includes base salary, bonus and perquisites. The median value for Basic Salary is $4,287,000 and for total compensation is $4,782,000. The difference between these two values is the value of stock options and long-term incentive plans, which is $495,000. Overall, these are far larger numbers than the values reported in the Towers Perrin study for 2005, although that study focuses on smaller firms.

If we look at comparable values for the largest 350 American firms for
2006, we see that median base salary was $1,045,084, median bonus pay was $1,553,200, and median total compensation was $6,548,805 (Lublin 2007). The American figures are higher but not by as much as might be expected. The big difference in pay composition is in the size of the stock option component of US pay: US firms paid roughly $3,950,000, whereas the German firms paid only $495,000. This accounts for most of the pay differential.

Are there other factors that make CEO pay in the US so much higher

Table 7.1  CEO compensation in the DAX companies (2006)

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than elsewhere? Base salary differentials play only a small role. Towers Perrin (2006) reports that in 2005, the annual salary of a US CEO was well over $500,000. While this was the highest figure among the 26 countries covered, CEOs in both the UK and Switzerland had base pay that exceeded $500,000 annually (although lower than the American level), and chief executives in only six of the countries surveyed were paid less than $250,000 in base pay.

Another potential candidate to help explain the pay gap is perquisites. On closer examination, though, they seem to be a minor factor. Perks make up a relatively small part of US CEOs’ pay in the Towers Perrin data. Furthermore, at least as of 1996, US firms ranked fifth out of 12 industrialized nations in the total value of fringe benefits offered by US corporations to CEOs (Abowd and Kaplan 1999).

Furthermore, American CEOs do not seem to sacrifice job security as part of a trade-off for higher pay. Although some commentators, including Wilhelm (1993), have suggested that chief executives outside the US do not face the same external scrutiny as their American counterparts, the evidence is to the contrary. At least in the 1980s, CEOs in Japan and Germany were, if anything, more likely to be dismissed than American chief executives if a company suffered a major share price decline or a drop in earnings (Kaplan 1997). Moreover, an international study conducted in 2000 showed that CEO turnover is equally high across industries and regions worldwide (Marshall 2000).

C Evidence of compensation convergence

To summarize, what distinguishes America’s executive compensation arrangements from those elsewhere is long-term incentive-based pay. As noted above though, incentive-oriented pay seems to be becoming more popular outside the US. For instance, annual bonuses, an important component of incentive-based variable pay, are becoming a more important element of total CEO compensation. The Towers Perrin survey of global pay and benefits for 2005 indicates that, out of the 26 jurisdictions covered, in 18 the annual bonus/salary ratio was higher for CEOs than it was in 1998 (Towers Perrin 2006).

The same pattern is evident with long-term incentive compensation. According to the Towers Perrin data, in 1998 there were ten jurisdictions where chief executives did not participate in a long-term incentive scheme. By 2005, there was only one (Towers Perrin 2006). Moreover, in those countries where long-term incentive plans were in place in 1998 and 2005, for CEOs the long-term incentive scheme/base salary ratio increased in almost all instances.

The Towers Perrin (2001) report on the usage of stock options confirms
that long-term incentive-oriented pay is becoming increasingly commonplace outside the US. The study examined the practices of large, local companies headquartered in 22 different countries, and found that such compensation was prevalent in only a handful of jurisdictions in 1997. However, the report projected that by 2003 it would be standard practice to have a long-term incentive scheme in place for their CEOs in the countries surveyed. The report further indicated that stock option plans are the most popular type of performance-oriented compensation. In nearly all of the companies surveyed that offered long-term incentive pay plans, stock options were used much more widely than LTIPs. In fact, the 2005 version of this study shows that incentive-oriented pay is now prevalent in most countries (Towers Perrin 2005a).

Fung (1999) and Kroll (1997) report that, traditionally, stock options were an American pay practice that was not followed elsewhere. In the UK, for example, stock option plans were largely unknown until the mid-1980s, when large numbers of companies began to adopt them (Kay 1995; Mazur 1995). Around the same time, stock options began to gain ground in some Continental European countries (see Alcouffe and Alcouffe 1997). However, according to Prigge (1998, p. 967) and Melis (2000), they remained of negligible importance in Germany and Italy. Moreover, according to survey evidence, long-term incentive compensation of any sort was virtually unknown in Belgium, the Netherlands, Sweden and Spain (Abowd and Kaplan 1999). Practices are changing in Europe though. Cheffins and Thomas (2004) found that, by the late 1990s, growing numbers of European executives were receiving part of their pay in stock options or LTIPs.

Has this shift impacted executive pay? There is a clear trend in Sweden toward higher executive salaries. Remuneration to executives in companies listed on the Stockholm Stock Exchange increased by 70 percent during the period between 1997 and 2002 (Nordic Investor Services 2004). Similarly, the number of long-term incentive programs for executives has increased substantially over the last 15 years. In 1994, there were around 50 programs in place among the companies listed on the Stock Exchange, whereas the corresponding number for 2004 was 700.

Elsewhere, similar trends can be observed. In Japan, stock option plans were virtually unknown traditionally (Kester 1991, p. 78; Brull 1995; Berger 1988). Today, a growing number of Japanese companies have created stock option schemes for senior employees (Benes 2001; Ghahremani 2000). Similarly, while Hutchinson (1992) reports that stock option plans were uncommon in Australia in the early 1990s, Bird and Hill (1999) and Witcher (1998) find that performance-based compensation is now widely accepted there. Canada shows the same trend toward more widespread use
of stock options since the early 1990s (Globe & Mail 1999; National Post 2001).

However, stock options and similar incentive schemes remain a much more important component of CEO pay in the US than they are in other nations. One indicator of this is that the ratio of long-term incentive compensation to salary remains considerably higher in the US than elsewhere. Some raw numbers illustrate the point: Conyon and Murphy (2000) found that for CEOs that received this form of compensation in 1997, the median option grant in the US was nearly 20 times that awarded to British chief executives.

The conditions attached to stock options vary tremendously between the US and other countries as well (Towers Perrin 2005b). In the United States, stock options generally do not have performance conditions attached to them (Towers Perrin 2005a). If the company’s stock price increases, then executives benefit, even if the amount of the increase is less than that for the stock market as a whole or the firm’s competitors (Dorff 2007; Hall and Liebman 1998; Rappaport 1999). As Hall and Liebman (1998) emphasize, ‘experience in recent years has shown that, by linking salaries to stock options, performance pay led to an explosion of compensation due to windfall profits’. Companies in most other countries commonly issue stock options that are subject to performance conditions, so that the company must meet specified ‘benchmarks’ (for example, exceeding designated earnings per share targets) for the option to have economic value (Towers Perrin 2005b). Such performance conditions are the norm in Australia, Germany, Italy, the Netherlands, South Africa and the UK and they are ‘expected to continue to grow’ (Towers Perrin 2005a).

Increased use of performance-related pay will result in higher executive pay generally because executives demand additional compensation for assuming the greater risk of having their pay tied directly to shareholder return. These risks include a lack of diversification for the executive, as well as the risk of marked fluctuations in the company’s stock price. Furthermore, CEOs may worry about having their personal net worth tied to stock prices that are subject to many other factors besides the skill and effort of a company’s top people.

Nevertheless, performance-based pay does have the benefit of linking managerial compensation more closely with shareholder returns and therefore focusing managers on raising those returns. According to Cheffins and Thomas (2004), talented executives will usually accept the risks associated with having their compensation linked closely with shareholder return if the potential rewards are large enough. So it seems logical to conclude that international shifts toward the use of more pay for performance may well push pay packages toward the American model.
4 Market-oriented drivers of executive pay

Although companies outside the United States pay their CEOs quite differently than American firms, there is some evidence that companies around the world are shifting towards the US pay paradigm (see Kay and Rushbrook 2001; Clegg 1999). Are market forces of various types the impetus for such a change? In this section, I look at how influential these market dynamics are likely to be in the future.

A Evolving share ownership patterns

One factor that may influence executive compensation arrangements is a company’s ownership structure. Cheffins and Thomas (2001) observe that in a publicly traded corporation with highly dispersed share ownership, managerial agency costs can be reduced by aligning managers’ incentives with those of shareholders through the use of stock options and long-term incentive pay whose value fluctuates with the company’s stock price. This results in pay packages that contain substantial equity-based incentives for managers to maximize share price.

The United States and the UK are good examples of dispersed ownership systems. Managerial agency costs are an important problem, but shareholder monitoring has historically been weak. Cheffins (1999) notes that US and UK firms rely on incentive pay systems to more closely align the interests of managers and shareholders. Cheffins and Thomas (2001) posit that, for this reason, investors in the US and the UK have, at least until very recently, strongly advocated the use of pay for performance in executive compensation.

For executives, though, substituting stock options for other forms of compensation increases the riskiness of their pay package. Executives discount the value of stock option awards to reflect this risk (see Hall and Murphy 2002; Muelbroek 2001). Thus, companies must offer more options and greater upside potential to compensate for the higher risks of no returns if the options fail to pay off. As a result, American and UK firms’ shareholders have generally been content to see executive pay rise substantially so long as the increase has been incentive-oriented (Cheffins and Thomas 2001).

In other major industrial countries, however, concentrated share ownership is the norm. According to Berglöf (1997, pp. 157–64) and Blommestein (1998, pp. 56–9), in jurisdictions falling into this concentrated category, many large companies do not have shares traded on the stock market and those which do frequently have a dominant shareholder. Thus, as Cheffins (2000b) observes, in Continental Europe and Asia, where firm control is more highly concentrated, a control shareholder or control group has the power and the means to discipline disloyal or ineffective
managers. Milbourn (1998, p. 174) suggests that shareholder monitoring acts as an alternative method of aligning shareholder and manager interests. Furthermore, Bates et al. (2000) report that control shareholders will be adverse to share-based incentive schemes since managers could be transformed into major shareholders and thereby dilute the ownership rights of the controlling group.

Share ownership can also affect executive compensation because executives at firms with control shareholders have good reasons to be sceptical of stock-based, incentive pay systems. At privately held firms, the stock market will not function as a method for valuing these securities. Even with publicly traded companies, many of these firms have small ‘free float’ of stock because of their concentrated ownership structure, thereby leaving their stock prices strongly influenced by ‘noise’ unrelated to prospective future earnings, and weakening the ties between managerial effort and executive payoffs (Abowd and Kaplan 1999; Melis 2000).

For all of these reasons, pay for performance levels and more specifically the use of stock options should be less common in concentrated ownership economies than in dispersed ownership countries. According to Brunello et al. (2001), Ramaswamy et al. (2000), and Park et al. (2000), some empirical evidence from Canada, India and Italy supports these hypotheses. However, in many historically concentrated ownership countries, there is significant evidence that shareholder ownership is becoming increasingly dispersed. I next review evidence which suggests that traditional ownership structures are becoming less concentrated.

(i) **Sweden** Henrekson and Jakobsson (2005) report that corporate control in Sweden has historically been highly concentrated with a typical ownership structure limited to one or two family owners. Both public and private companies have concentrated ownership (Henrekson and Jakobsson 2005). In 1998, the largest shareholder in Swedish listed companies on average controlled 38 percent of the voting rights (Henrekson and Jakobsson 2005, p. 27). In 34 percent of the firms the controlling owner had more than 50 percent of the votes and as many as 82 percent of the firms had a well-defined owner with more than 25 percent of the votes (which in practice implied operational control of the firm). However, share ownership in Sweden has become more dispersed in recent years because of increased foreign investment and the new Swedish pension model that has created large state and corporatist pension funds that have invested in Swedish firms (Henrekson and Jakobsson 2005).

(ii) **Germany** Share ownership patterns in Germany have shifted drastically over the last decade. According to Streeck and Höpner (2003, p. 118),
historically, the biggest German companies were controlled by a network consisting of domestic investors, banks, insurance companies and families who owned those companies. In addition, they note that many important German companies, such as the Deutsche Post and Deutsche Telekom, were state-owned enterprises. However, things are quite different today: 53 percent of the shares on the DAX, the stock index for the 30 largest German companies, are in foreign hands.\(^4\) For example, as of 2005, the majority of stock of Adidas, BASF, Commerzbank, Continental, Deutsche Bank, Deutsche Börse, Schering and Siemens was controlled by foreign investors (Kaiser 2005). As Figure 7.4 illustrates, stock ownership has become more widely dispersed at major German corporations.

Controlling for other factors, concentrated ownership by banks is associated with lower levels of CEO compensation at German companies, although family ownership increases compensation (Haid and Yurtoglu 2006). They find that pay for performance sensitivities are very low and concentrated ownership reduces them still further.

(iii) China The Chinese government has transformed its economy from a centrally planned economy to a market-oriented economy since

\(^4\) The DAX measures the performance of the Prime Standard’s 30 largest German companies in terms of order book volume and market capitalization. These data are available at http://deutsche-boerse.com/dbag/dispatch/en/isg/gdb_navigation/home?active=overview&timespan=1d&wpbpl=&wp=DE0008469008&foldertype=_Index&wplist=DE0008469008&module=InOverview_Index.
1979. (For an overview of Chinese enterprise reform, see Firth 2006a; Sun and Tong 2003; Kato and Long 2004.) The government established the Shanghai Stock Exchange and Shenzhen Stock Exchange in 1990 and 1991 respectively, partly in order to provide a stage for state-owned enterprises (SOEs) to raise funds (Kato and Long 2005). They observe that rapid economic growth occurred after the Chinese Communist Party’s Fourteenth Congress in 1992, at which the Party endorsed the idea of ‘building a market economy with Chinese characteristics’. Kato and Long (2005) report that one year later, the Chinese Company Law was promulgated, which articulated guidelines for SOE reform and regulated corporate governance for modern corporations in China. They explain that, as part of the economic reform, the government encouraged the privatization of SOEs, and since then more than 80 percent of SOEs have been restructured into corporate entities under the Company Law.

However, according to Firth et al. (2006a), this privatization process was only partial, since the state retained large equity positions in nearly all SOEs. For example, Kato and Long (2004) report that in 2003, more than 80 percent of the listed firms in China had a state agency, or an SOE, as their largest shareholder, leaving most listed firms effectively controlled by the government. Similarly, in 2001, the Chinese government held approximately 60 percent of all shares in listed firms (CFA 2007). ‘As a result, the persistent dominance of state ownership of company shares remains in many listed firms in the midst of the remarkable growth of the stock market and the government still looms large in the ownership as well as the control of most listed firms in China’ (Kato and Long 2004, p. 1). There is a negative relationship between pay-performance sensitivity and state ownership (Kato and Long 2005), perhaps because their controlling shareholders care less about maximizing firm profitability than other political concerns.

Privately controlled firms are quite different. While the number of privately owned, listed companies has increased gradually, these firms are generally controlled by a single shareholder (Firth et al. 2007, p. 5). Chen et al. (2008) observe that the largest and second largest shareholders own 32 percent and 12 percent, respectively, of the shares of listed firms. Pay for performance is much more common at these firms (Firth et al. 2006a).

(iv) India From the time of its independence in 1947 until the 1990s, the Indian government controlled most of its economy and most large firms were SOEs (Geis 2007). For many years, this meant that the Indian government was the only significant shareholder for much of the economy until a series of reforms led to a reduction in its stake. According to Parthasarathy et al. (2006), ‘[t]he Indian corporate sector today is dominated by “family owned” businesses where either a majority or a controlling stake in the shareholding
of a firm is owned by a particular family...'. In these firms, founding families play a dominant role in management (Kakani and Ray 2002).

A recent study of the Indian S&P CNX Nifty (the ‘Nifty’), an important index of Indian public companies traded on the National Stock Exchange of India, shows that while there has been some movement toward dispersion of stock ownership, largely because of increased levels of foreign investment by institutional investors, most large firms continue to have either a family group or the state as a control shareholder (Geis 2007). Geis notes that among the 50 firms in the Nifty, 80 percent have at least 30 percent of their stock held by a family group or the Indian government, while independent shareholders hold high percentages of the stock in only nine firms.

(v) Impact of changes to ownership structures on executive compensation

If concentrated corporate ownership structures are becoming more dispersed over time, executive pay levels and performance-based compensation may both increase in the future. Bratton and McCahery (1999) and O'Sullivan (2000) observe that this is particularly likely if the cause of increased dispersion is growing levels of foreign portfolio investment by US and UK institutional investors. These investors may therefore have greater leverage in countries where share ownership has traditionally been highly concentrated. Continental European, Asian and Latin American companies that want to raise funds on international capital markets may need to raise performance-based pay levels to appeal to these institutional investors, as Cheffins and Thomas (2001) report that American and British institutional shareholders have generally promoted pay-for-performance compensation packages.

Sweden is a good example. Henrekson and Jakobsson (2005, p. 1) note that over the past 20 years there has been a marked increase in foreign ownership of Swedish firms, more than in other developed industrial countries. This influx began in the mid-1980s, after the removal of substantive restrictions on foreign ownership of Swedish companies (Jacobsson 2007). The rate of increase was quite dramatic: until the early 1990s, foreign investors owned less than 10 percent of corporate stock in firms quoted on Swedish exchanges, whereas by June 2007 foreign ownership of shares in Swedish companies listed on the American market was 39.7 per cent (Statistiska Centralbyrån 2007). American investors were the largest single group, and account for about 11 percent, or about $676 billion, of the total equity of companies in the Swedish market. Academics studying Swedish stock ownership patterns, including Henrekson and Jakobsson (2005, p. 34), predict that the old concentrated family ownership model for Swedish firms will probably be replaced by more dispersed ownership by foreign owners and state or corporate pension funds.
How will this development affect executive remuneration? One study on the effects of internationalization on CEO compensation in Nordic firms finds that strong owners, or owners with significant control, reduce the level of CEO compensation in Swedish and Norwegian firms, stating that ‘large owners are better monitors of CEO pay than firms with more dispersed ownership’ (Oxelheim and Randøy 2005). The converse, however, is also true: moving towards a more dispersed ownership in public corporations will possibly lead to increased remuneration.

It would be a mistake to draw too strong an inference though. While investment patterns are making a growing number of companies outside the US and the UK more sensitive to the Anglo-American investors’ perspective, any shift in attitudes may just be superficial (Economist 2000; Karmin 2000). In other words, the preferences of American and English institutional investors may have only a marginal influence on executive pay practices for the foreseeable future.

Furthermore, the ownership shifts in Continental Europe may not continue in the direction of increased dispersion. While Van der Elst (2003) reports that it is becoming more common for European companies to join the stock market, other scholars, including Goergen (1998, pp. 51–6, 78–83), Mikkelsen et al. (1997) and Pagano et al. (1998), state that there is still a strong preference by firms to retain strongly concentrated ownership structures when they sell shares to the public. Thus, it could be the case that controlling shareholders will continue to play a dominant role on the Continent. This would presumably hinder any shift towards greater pay for performance and resultant higher executive pay levels.

B Cross-border hiring

A second important force that may affect international executive pay systems is the growing internationalization of the labor market for executives. Some commentators have suggested that the market for CEOs is becoming global, and that an increasing number of foreign CEOs run firms headquartered in other countries (Lyons and Spencer 2000). For example, Adobe, the San Jose-based software maker, recently hired Shantanu Narayen, an Indian national, as its CEO-designate (Times of India 2007). Other prominent hires include in 2001, Nissan’s promotion to CEO of Carlos Ghosn, a Brazilian of Lebanese descent and in 2004, Korea Exchange Bank’s hiring of Richard Wacker, former Vice President of GE, as its CEO (Herbstein and Jung-A 2004).

One possibility is that foreign companies may be concerned that American firms will offer their top executives larger compensation packages if they migrate to become CEOs in the US. This would put pressure on these firms
to change their managerial compensation systems to conform more closely to those in the US. One possible example is former Siemens AG CEO Klaus Kleinfeld, who left that company in 2007 to become COO (and soon CEO) at Alcoa. He received a huge signing bonus and an option-laden compensation package at the time of his move. This may cause German firms to adjust their executives’ pay to avoid any other defections.

The door could swing in the other direction as well, so that cross-border hiring of Americans to serve as CEOs of foreign firms could spark the reconfiguration of executive pay. If the American executive talent pool is deeper than elsewhere, companies headquartered outside the US may try to lure away American executives (Chwialkowska 1999; Plender 1999). Top managers in the US are unlikely to leave for another country unless they are offered a comparable compensation package to what they could get in the US. This means that any foreign company seeking to recruit an American executive might need to change its approach to CEO pay.

China provides some interesting lessons on this point. Few Chinese corporations have hired American CEOs, although in 2005 Lenovo Group Ltd, the largest Chinese computer company, hired an American CEO, William J. Amelio (China Daily 2006). Interestingly, Amelio’s total compensation in 2007 was $6,711,000 (Business Week 2008), which was 11.7 percent higher than the total compensation for the Chinese Chairman of Lenovo, Yuanqing Yang, notwithstanding the fact reported by Firth et al. (2006b) that in China a chairman is generally paid more than a CEO of the same firm. More generally, it appears that foreign executives working in China are paid two or three times more than their Chinese counterparts (Chinese Government 2006). China’s experience suggests that pay scales there will not adjust to international levels quickly, if at all, because of the presence of foreign executives.

Will the emergence of a global market for executive talent have a significant impact on current practices? Some evidence suggests it will be important. According to Gross and Wingerup (1999), growing competition for managerial talent has forced more companies to recruit internationally. Lyons and Spencer (2000) report that companies are increasingly willing to look for the best managerial talent irrespective of the individual’s country of origin. On the supply side, they note the existence of large numbers of foreign executives who speak English fluently, have honed their business skills in countries outside their own and are willing to move abroad to further their careers. For example, over 50 percent of German DAX executives have worked abroad.5 This confluence of more truly international talented executives combined

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5 http://www.mediadefine.com/page,4563,62171,0,0,100,0,de.htm.
with more companies willing to select them suggests that internationalization will push pay levels toward the American model.

One example of the effects of these movements on executive pay is Wolfgang Reitzle. Until 1999, Reitzle was an officer and director of BMW AG (Hoffritz 2000). Reitzle left BMW in 1999, after not being appointed as the new CEO, and went to Ford, where he worked from 1999 to 2002 as the CEO of Ford’s Premier Automotive group (comprising all the luxury brands of the Ford Group, that is, Jaguar, Aston Martin, Volvo, Land Rover, Lincoln, Mercury). By 2002, he earned slightly more than Ford’s Vice Chairman Carl Reichard. In 2002, he left Ford with a large severance package, turned down a similar job at GM, and became the CEO at Linde AG, where he was the second highest paid CEO in Germany. Clearly, Reitzle’s ability to move between the US and German labor markets helped to propel his compensation levels upward.

Even surging cross-border executive hiring may not lead to a strong convergence trend in the area of executive pay in the foreseeable future though. Foreign companies are unlikely to recruit an American CEO unless they speak the native tongue fluently. In one extreme example, Goldman Sachs could not appoint Richard Ong to be the CEO of its Beijing joint venture, because his Chinese language skills were not good enough to pass the mandatory test created by the China Securities Regulatory Commission (CSRC) for senior manager at securities firms in China (Chan 2007). Firms may also shy away from hiring an American because paying them on the American scale could create discord among incumbent executives. While Lyons and Spencer (2000) note that the UK is a popular destination for American CEOs, only companies in dire need hire directly from the US since it is viewed as risky (Plender 1999). In Sweden, relatively few foreign nationals are CEOs of Swedish companies. In 1998, it was rare to find a foreign-born CEO heading up a publicly traded firm in Norway and Sweden. Oxelheim and Randøy (2005) reported that less than ten non-Scandinavians were CEOs of listed Norwegian and Swedish companies. Today, there are a few, including Stuart Graham (American), President and CEO of Skanska (Sweden’s sixth largest company) and David Brennan (American), CEO of AstraZeneca (Sweden’s second largest company). Conversely, Björck (2004) reports that very few Swedes run foreign companies.

On the other side of the ocean, American firms recruiting foreign-born

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7 http://www.busrep.co.za/index.php?fSectionId=641&fArticleId=3145350.
managers face a number of barriers, including tough immigration regulations (Katz 1997). Moreover, the UK experience suggests that very few top executives are actually in a position to move, although the potential for such moves has been the justification for significant increases in executive pay at some firms (Martin 1993; Waples 2000). Some Canadian commentators, including Berman (1997), have claimed that CEOs at internationally competitive companies might be able to move to the US (Gay 1996; McFarland 1996). However, Gates (1991) notes that few Canadian CEOs have sought opportunities in the US and many lack the credentials to work for larger firms outside the domestic market.

C Transnational mergers and acquisitions
Cross-border mergers and acquisitions are another force that could foster a shift in executive compensation practices. Black (2000) reports that cross-border activity has been booming in recent years, a fact that Agami (2001) attributes to a variety of factors including heightened competitive pressures, improvements in technology and communications, and the growth of global markets for goods and services. The size of these transactions should not be underestimated. American firms have made a number of major foreign acquisitions in recent years. For instance, in August 2006, the American firm Rite Aid bought the Brooks and Eckerd drugstore chains for $3.4 billion,10 and in May 2007, the American firm Mylan Laboratories Inc. bought the generic drug division of the DAX-listed Merck KGaA for $6.6 billion (Gangahar 2007).

But foreign firms have been just as active, or even more so in the US. Some examples of recent American acquisitions by foreign firms include BASF AG’s 2006 $5 billion acquisition of the Engelhard Corporation,11 Siemens AG 2007 acquisition of Texas-based UGS for $3.5 billion,12 Hitachi and GE’s 2007 merger of their nuclear power business (Kachi and Tomisawa 2007), Royal Bank of Scotland’s 2004 acquisition of Charter One Financial for $10.5 billion (Wells and Wighton 2004) and BNP Paribas’ 2004 acquisition of Community First Bankshares for $1.2 billion (Financial Times 2004).

Given the magnitude of the deals completed, this wave of international

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consolidation could impact executive compensation packages because when merging companies’ managerial pay arrangements differ, they may move to adopt a single pay system. Thus, for example, if an American firm acquires a foreign firm in a cross-border acquisition, this can create pressure at the combined firm to move toward American pay practices. The executives of the acquired company are likely to be less well paid than their American counterparts. If separate pay systems are retained after the merger, the top executives at the acquired firm would likely be dissatisfied, perhaps leading to harmful defections (Romanchek 1999). To preserve internal harmony, and ensure that good people are retained, the new firm will likely move toward American-style compensation packages. If this is correct, and US firms continue to make significant acquisitions, the cross-border acquisitions by American companies should create momentum toward US-style executive compensation.

Conversely, foreign firms making acquisitions in the US face the problem that American targets previously offered US-style remuneration packages to its executives. Therefore, one by-product of a merger could be huge internal pay inequities between the home-country executives and the American-based executives, with resulting pressure on the parent company to resolve the problem by increasing home-country executive pay. While theoretically the acquirer could slash pay for its US-based managers, Murphy (1998, p. 2497) and Richard (2000) note this would likely disrupt the retention of key incumbent talent and harm efforts to recruit new people. In one well-known instance, the 1998 merger between Daimler-Benz AG, a German automobile manufacturer, and Chrysler Corporation, an American competitor, the compensation of Chrysler’s No. 2 executive exceeded that of the top ten Daimler-Benz executives combined (Cheffins 2001). This inequity led the newly merged Daimler-Chrysler to develop a pay system in order to recruit and retain talented managers to run its American operations (Fung 1999).

D The growth of multinational enterprise

Branson (2000) argues that another important force affecting international executive compensation practices is the enormous expansion in the number and size of companies that operate on a multinational basis. One manifestation of this growth is that foreign direct investment by firms around the world reached record highs this decade.13 In terms of executive pay, the key dynamic is that multinational businesses often find it important to use a universal standard for managerial pay arrangements. Such a standard

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13 [www.unctad.org](http://www.unctad.org)
allows them to develop incentive-based compensation on a company-wide basis (Baranski 1999; Fung 1999).

When multinational corporations make executive compensation decisions on a worldwide level, ‘more uniform executive pay structures are the result’ (Richard 2000). For multinationals headquartered in the United States, a universal policy should result in an American type of executive pay. According to Deresky (2000, pp. 366–7), host-country nationals employed by American companies will undoubtedly benefit because their pay will generally be raised to US levels. There may also be a secondary impact on the market for managerial talent in the host countries if the US-based multinationals hire local executives to fill top posts. Presumably this will force domestic companies to raise their pay levels to ensure their top managers stay put or to recruit new managers (Murphy 1998). Some multinational firms prefer not to use uniform executive compensation systems internationally, and instead take into account local compensation norms, national tax considerations and other conditions (Towers Perrin 2005a). Towers Perrin ‘found that nearly 40% of US multinationals no longer grant the same number of options to all employees at an equivalent organizational level worldwide, but instead differentiate awards according to geography’, which typically leads to lower option awards to non-US employees. They report that this change reflects the impact of the FASB’s decision to require expensing of stock options and will reduce pressure on non-US companies to increase option awards.

These types of changes lead to top managers being paid differently within the same firm depending on where they work. However, multinationals headquartered outside the United States with substantial American operations may not have this option because while they will need to offer competitive pay in the US in order to recruit or retain their American managers, doing so may well lead to the parent company’s top executives earning less than their US subordinates (Berman 1997; Johnston 1998; Lublin 1991). Home country executives may lobby for US assignments to get higher pay, then demand similar compensation at home as a condition of returning there. In the face of such pressures, multinational firms may feel compelled to shift to a universal pay policy and thereby contribute to the globalization of executive pay.

Oxelheim and Randøy (2005) examined 90 Norwegian and 97 Swedish companies listed on their countries’ respective stock exchanges between 1996 and 1998, looking at the effect of internationalization on CEO pay, finding a positive relationship between CEO compensation and foreign exchange listing, Anglo-American board membership and export and foreign sales intensity. They claim that companies exposed to foreign ownership and foreign management have greater risks for CEOs, which in turn lead to a
higher risk premium for the CEO. Furthermore, the supply of competent CEOs in a large international business is very limited since they require additional skills, such as overseas experience, the necessary language skills and an understanding of cultural differences. In these ways, then, growth in multinational enterprises can bring about dramatic changes in CEO pay.

E Conclusion
It is hard to know how strong these forces for executive pay convergence are. The apparent movement towards more dispersed share ownership in many countries could lead to stronger pay for performance (and therefore higher pay) at many foreign firms, but the current trend may not last. Similarly, cross-border transactions can promote American-style managerial pay, but economic fluctuations and political uncertainties could reduce the current high level of activity.

Moreover, these market forces may not have as decisive an influence in the area of executive compensation as it may seem. Other factors, such as immigration laws, may limit their impact. Legal rules, both direct and indirect, can affect companies’ executive pay arrangements. Soft law, such as guidelines and rules promulgated by private organizations, and business/national culture in the countries in which companies operate, can also be very important. The next four sections consider the effect of these forces.

5 Corporate law and the globalization of executive pay

A Direct regulation
Corporate law rules can influence executive pay levels and composition. Direct regulations can state how executive pay arrangements must be structured, as they did in India under the Companies Act of 1956. By law, total managerial compensation could not exceed 11 percent of a company’s net annual profits, and the pay for directors acting in a managerial capacity could not be raised without government approval. Moreover, government pay increase guidelines included a ceiling on annual pay based upon the President of India’s salary (Ramaiya 1971). As India moved away from a socialist, state-dominated economy, these laws were liberalized in the early 1990s (Ramaswamy et al. 2000). Essentially, unless a company is unprofitable, it is free to work out a suitable remuneration package for

14 Indian Companies Act No. 1 of 1956.
its managerial personnel within the limit of a designated percentage of net profits (Ramaiya 2001) As a result, India moved toward having more similar compensation practices to those found in other countries.

Generally, corporate law does not directly regulate executive compensation (Wymeersch 2001), although a few countries have some minor regulations. For example, Argentina and the Philippines prohibit companies from paying directors more than a designated percentage of annual earnings.16 Australia17 and Germany18 have requirements that executive pay must be ‘reasonable’. In Brazil, the corporation’s administrators (essentially its directors and executive officers) must be paid only the amount required by their experience, reputation, duties and the market value of their services (Neto and Levy 1998).

With the exception of the now defunct Indian regulations, these types of restrictions have done little to constrain pay levels. Australia is a good example: since 1992, when it introduced its ‘reasonable’ compensation requirement, executive pay levels have risen substantially (Bosch 1998). The same can be said of Germany, with its rule that compensation levels reasonably correspond to the services provided (Oppenhoff and Verhoeven 2007, §24.03[1][c][ii][B]). For background on why the relevant provision does not have a major practical impact, see Cheffins (2001).

B Breach of duty and related causes of action
A second potential constraint on executive pay levels is judicial intervention. As Thomas and Martin (2001) note, in many countries, courts may review a company’s directors’ decisions on setting executive pay, if there

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16 In Argentina the amount is 25 percent of earnings (5 percent if no dividend is distributed) and in the Philippines it is 10 percent of net income before tax. See Nexia International (1996), at pp. 1, 4, 168; Van Nieuwenhove (1998).

17 A public company is prohibited from providing remuneration to managers that is not ‘reasonable’ unless the arrangement has been approved by the shareholders: s. 211 of the Corporations Act 2001, No. 50 of 2001.

18 In Germany, most firms that distribute shares to the public do business as a stock corporation or ‘Aktiengesellschaft’ (‘AG’) and an AG’s management board will be staffed by senior full-time executives. The total remuneration of these executives has to be adequate to the ‘job of the executive’ and the ‘position of the corporation’. German Stock Corporations Act of 1965, AktG §87(1). To determine whether a specific remuneration is adequate to the job of the executive, the following aspects have to be considered: the character of the task related to the job, the degree of difficulty, the significance for the company and the amount of responsibility which comes along. Wolfgang Hefermehl, Annotations to the AktG, volume III, § 87 para 7 (Munich, Beck, 2004); Joachim Meyer-Landrut, in C.H. Barz, Annotations to the AktG, volumes 1–2, § 87 para 3 (Berlin: de Gruyter, 1973), Schneider et al (2000), at pp. 571, 574.
are grounds to suspect that those directors have breached their duties of care, loyalty or good faith owed to the company. According to Thomas and Martin (2001), derivative suits have been used in numerous instances in the US to challenge managerial compensation arrangements. They observe that while such actions succeed most frequently in challenging pay at privately held corporations, they provide a sporadic check on managerial remuneration even at public companies.

Overall, however, litigation seems unlikely to have a meaningful effect on international executive pay trends. In some countries, such as China, the concept of the derivative suit is so new that it cannot be determined if it will become an effective remedy for shareholders. Even in the US, derivative suits have had little influence over increases in managerial pay, perhaps because judges are unwilling to act as corporate paymasters. Undoubtedly, judges in other countries will be influenced by this type of concern as well (Cheffins 1997a, p. 674; Adenwala 1991; Cheffins 2001).

Even an activist judge would not be enough in most jurisdictions though, as plaintiffs in most countries face significant procedural barriers to pursuing these actions. For example, Stecher et al. (1997, pp. 9–10) observes that in many civil law countries, shareholders cannot bring derivative suits, or face being dismissed for lack of standing if they do not own a very substantial percentage of a company’s stock (often 5 or 10 percent, according to Neto and Levy 1998, p. 65). In Sweden, for instance, a shareholder must own 10 percent of the outstanding shares in order to bring a derivative suit against members of the board.19 In most common law countries, there are few narrowly focused exceptions to the principle that only the company can pursue directors for breaching their duties to the firm, and according to Cheffins (1997a, pp. 315–16; 665–6), these are of little help to disgruntled minority shareholders. All recoveries go the company rather than the shareholder, so filing suit is more trouble than it is worth (Cheffins 1997b).

Perhaps in recognition of these limitations, a number of common law jurisdictions have enacted statutes that create judicial remedies for shareholders who have been unfairly prejudiced by a company’s actions. These provisions permit a minority shareholder to file suit free from the procedural constraints attached to derivative actions and to seek a personal recovery (Cheffins 1997b). Nevertheless, courts have been reluctant to permit such challenges to excessive compensation except at privately held

19 Aktiebolagslagen (ABL) (Companies Act), 29:7 (Sweden).
firms (Thomas and Martin 2001; Farrar and Hannigan 1998, pp. 450–51). In short, litigation seems unlikely to have much impact on executive pay at the publicly traded companies that dominate the international economy.

It is worth noting that in Germany, at least, criminal charges may be brought against CEOs in limited circumstances for taking excessive severance pay packages. In a recent case arising out of the hostile acquisition of Mannesmann, a German firm, by Vodafone, a British company, the supervisory board of Mannesmann approved golden parachutes for senior Mannesmann executives of €57 million (Simensen 2006). German prosecutors filed criminal charges against the former CEO of Mannesmann, Klaus Esser, seeking up to three years in prison for Esser and other members of the supervisory board. After an initial defeat in the trial court, the plaintiffs appealed. On appeal, Germany’s highest appellate court noted that granting non-compensation recognition payments (golden parachutes) that are a special reward and bring no future value to the concern injures the company’s entrusted assets. The case was remanded to the trial court. Ultimately, the trial proceedings were stopped when the defendants agreed to make a settlement payment of $7.6 million, but with no criminal sanctions (Bulkeley 2006). However, it seems likely that this one case had a dramatic impact on German executives’ willingness to seek, and German directors’ willingness to offer, this form of compensation in the future.

C Shareholder voting
Shareholder voting requirements imposed by corporate law constitute another potential constraint on executive pay levels. In most countries, a company’s board of directors is given the lead role in determining executive pay (Cox et al. 1998), or if a two-tier board structure is used (as in Germany) the ‘supervisory’ board is charged with this duty (Cheffins and Thomas 2001). However, stockholders may have a role in the process. Some countries give shareholders the power to fix directors’ annual pay.20 In other jurisdictions, shareholders have to approve the creation of stock option plans for top executives.21

Sweden is an interesting example. In 2006, the Swedish Companies Act was amended to strengthen the role of shareholders in deciding on remuneration for leading executives and board members. These amendments

21 See Kaplan (1997), discussing Germany and Japan. The position is the same, for example, in France: Marty and Dumas (1997), at 52, 52.
provided that, at publicly traded companies, the shareholders, with the guidance of the board of directors, must approve guiding principles for remuneration to employees in leading positions, including policies regarding the use of options and other similar incentivizing instruments.\textsuperscript{22} Once adopted, these principles must be followed by the board unless the shareholders are informed and given an explanation for the deviation. Moreover, the new rules provide that the shareholders must approve the compensation for board members. It remains to be seen if these new rules will curb increases in Swedish CEOs’ pay.

Shareholder voting rules seem designed to give shareholders the power to curb excessive managerial compensation, but are often too narrow to accomplish this goal. For instance, giving shareholders the power to set director pay does not permit them to regulate the contracts and pay packets that firm managers receive. Nor would one expect shareholder voting to be important in countries where shareholder ownership patterns feature controlling shareholders. While requiring a shareholder vote on executive pay might appear to be significant, in fact dominant shareholders already determine executive pay regardless of whether a shareholder vote is required.

In dispersed share ownership countries, such as the US and the UK, shareholder voting on executive pay is a popular issue for institutional investors. However, at present, the available empirical evidence suggests it functions as a potential check on executive pay only when such compensation arrangements significantly deviate from the norm (Cheffins and Thomas 2001). This suggests that even if more countries move from concentrated ownership patterns toward the more diffuse Anglo-American pattern, this shift would not result in shareholder voting emerging as a significant influence on executive pay.

\textit{D Restrictions on the distribution of stock to executives}

According to Cheffins (2001), companies with executive stock option plans will generally issue new shares to the option holders when they exercise their options, or alternatively repurchase outstanding stock in order to sell it to their executives. Many nations, however, heavily regulate companies’ ability to issue new stock and/or prohibit stock buy-backs except in special circumstances (Thorpe 1995). As a result, it may be very difficult to employ executive stock option schemes.

Germany is a good example. Prior to the enactment of the Corporate Sector Supervision and Transparency Act (KonTraG) on 1 May 1998, German corporations were not permitted to issue stock options unless they

\textsuperscript{22} Aktiebolagslagen (ABL) (Companies Act) 7:61 and 8:51 (Sweden).
were based on convertible bonds.\textsuperscript{23} However, even those convertible bond options were often challenged by shareholders in German courts. Therefore only a few of the largest German companies granted those options before May 1998, for example, Deutsche Bank, Volkswagen und Telekom. After May 1998 and the passage of the KonTraG, stock option plans became more common, especially among large companies quoted on the DAX, because now it was possible to grant options to purchase newly issued shares.

In Sweden, the Swedish Companies Act requires shareholder approval of the issuance of new shares to be used as part of a compensation package to executives.\textsuperscript{24} To approve this issuance, a 90 percent supermajority of the shares represented at the shareholders’ meeting is needed for approval. In other words, a stockholder representing more than 10 percent of the shares at the shareholder’s meeting may veto an incentive program based on the issuing of new shares. This occurred in 2007 at the annual shareholders’ meeting for Ericsson when foreign institutional investors, apparently on the recommendation of Institutional Shareholder Services, voted against an employee incentive plan.

Restrictions on the use of stock options are of diminishing importance elsewhere. During the late 1990s, Japan, South Korea and Finland all liberalized their statutory rules to make it feasible for corporations to grant executive stock options (Kim and Lee 1998). Shareholder approval still must be obtained before option plans can be created, but this does not seriously constrain implementation of them. Indeed, large numbers of Korean and Japanese companies have begun granting stock option plans (\textit{Korea Herald} 2000; Kawamura 1997).

\section*{E \ Disclosure}

Disclosure regulations in many countries require corporations to periodically publicly reveal some details concerning their executive compensation arrangements. The US system has probably the most demanding set of rules in this regard. Under American federal law, a corporation subject to the 1934 Exchange Act’s reporting requirements must include in its proxy statement a description of the corporation’s general approach to executive pay and the amounts and types of compensation (salary, bonuses, share options and other designated categories) paid to its CEO and the other four highest paid executive officers. In addition, the company must include a performance graph comparing the corporation’s shareholder return over

\begin{thebibliography}{99}

\bibitem{23} http://ec.europa.eu/enterprise/entrepreneurship/support_measures/stock_options/germany.pdf, p. 4.
\bibitem{24} Aktiebolagslagen (ABL) (Companies Act) 16:2 (Sweden).
\end{thebibliography}
a five-year period to that of a similar index of its peers and a general stock market index, such as the S&P 500.

The UK, Canada and Australia regimes are the closest to the American disclosure rules (Conyon and Murphy 2000; Zhou 2000; Quinn 1999). Elsewhere, disclosure regulation is lax, with some jurisdictions lacking any reporting requirements, or more commonly, simply requiring that public firms disclose the total amount of director compensation (Nexia International 1996). However, these disclosures do not include the details on any individual director’s pay, including the types of compensation they receive or whether it is performance-related (Gordon 1999). Typically, management compensation is not separately disclosed either.

In China, the PRC Company Law (third amendment), which is the fundamental law in the corporate law area, generally requires a company to periodically disclose the remuneration received by its executives to its shareholders.25 This law also requires disclosure of executives’ stock holdings and any changes thereto. Subsequent regulations have clarified that executive compensation information must be disclosed in the company’s annual report, while executives must report any changes in their stockholdings within two trading days after such change.

National disclosure policy may influence the use of pay for performance compensation outside the US. As previously mentioned, Anglo-American institutional investors have encouraged foreign firms to use pay for performance systems to tie managerial interests with those of shareholders. Strong disclosure requirements could reduce the cost of shareholder monitoring of the relationship between pay and performance (Iacobucci 1998). Data from Canada suggest that the adoption of enhanced disclosure regulation helped to cause a shift in favor of pay for performance at publicly traded companies (Iacobucci 1998, p. 502–3; Park et al. 2001, pp. 347–8).

According to Iacobucci (1998) and Loewenstein (2000), greater disclosure may also accelerate increases in executive compensation. The availability of information about what similarly situated competitors are paying their executives will likely alert top managers who are receiving less than their peers. Eager to reverse their inferior pay standing, and perhaps correct a perceived loss of social status, these managers will make higher future pay demands (Thomas and Martin 1999). Directors on the firm’s Compensation Committee may be sympathetic to such requests because

25 See Article 117 of the PRC Company Law (third amendment), which states: ‘A company shall periodically disclose to its shareholders the remuneration received by its directors, supervisors and senior management personnel from the company’.
they may believe that below average executive compensation indicates that the firm’s management is ‘below average’ (Financial Times 1999), and might well lead top executives to defect to firms offering more generous pay (Rodgers 1996). The end result is higher pay for managers.

Generalizing from this result to the broader CEO labor market, this process may lead to a ratchet effect: if all companies seek to match or exceed the average pay for CEOs, then pay levels move inexorably higher (Financial Times 1999; Rodgers 1996). The fact that during the 1990s the introduction of more stringent executive pay disclosure requirements was accompanied by accelerated increases in managerial remuneration in Australia, the UK, and Canada, is consistent with this hypothesis. Moreover, empirical work by Park (2001) on Canadian executive pay supports this claim. News reports in Sweden, such as Carlsson (2004) have drawn similar conclusions.

To the extent that greater executive pay disclosures lead to higher managerial pay, then any movement in that direction by countries with lax regimes is significant. Villiers et al. (2001) cite the example of Spain, which enacted laws in 2000 requiring publicly traded firms to divulge a wide range of information when they grant options to board members. Similarly, after 2002, French companies were obliged to report the individual pay of all company officers (Les Echos 2001). Most importantly, in Germany, before 2005, publicly traded companies were only required to disclose the aggregate compensation for the entire board of directors. On 30 June 2005, the German legislature passed the Disclosure of Executive Remuneration Act (the ‘VorstOG’) which requires mandatory disclosure of the individual pay arrangements (including basic salaries, long-term incentives and many other aspects) for directors of listed companies. Sweden enacted similar legislation in 2006, so that it is mandatory for Swedish companies to include information on compensation to the board of directors, the CEO and other leading executives in their annual reports. Towers Perrin (2005a) finds that increased levels of public disclosure about long-term incentive pay plans are likely to be required by many other countries as well.

Simultaneously, there has been a trend toward the greater use of stock options internationally. Towers Perrin (2005a) found that the use of stock options has become almost universal in European and American firms, while option use has significantly increased in Asia and Latin America since 2001. The study reveals that the laggards are India and South Korea, and even in those countries 20 and 25 percent, respectively, of companies

use stock options as an element of executive pay. If these two sets of changes go hand in hand, then disclosure reform may help foster a shift towards more pay for performance in executive pay packages.

6 Other legal factors

A Tax

Tax law may have an impact on the globalization of executive pay. For example, an executive’s income tax rates could affect managerial compensation. If a typical company tailors executive compensation arrangements to match these managers’ preferences, then CEOs in low marginal tax rate countries are likely to be more highly paid. Executives in low tax countries will be able to keep more of what they earn, and therefore will attach greater value to it. Thus, we would expect that lower income tax rates would be correlated with higher executive pay, which is consistent with the available historical and empirical evidence (Cheffins 1997a, p. 704; Abowd and Bognanno 1995).

Taxes may also affect the use of stock options. Outside the US, many countries’ tax regulations give unfavorable treatment to stock option pay (International Tax Review 1999; Chwialkowska 1999; Delaney and Wessel 1999; Monteiro and Shah 2000). Sweden is a good example, as one recent academic study concludes: ‘. . . the use of stock options to encourage and reward entrepreneurial behavior among employees is highly penalized by the tax system, since gains on options are taxed as wage income when the stock options are tied to employment’ (Henrekson and Jakobsson 2005). Conversely, Egginton et al. (1993) and Kay (1995) cite UK tax reforms enacted in the 1980s as a catalyst for stock options’ popularity. Collaboratively, Towers Perrin (2005a) found that, for many of the countries surveyed, taxation was an important determinant of stock option implementation.

Japan, India and a number of Continental European jurisdictions have changed their tax treatment of stock options in recent years (S.J. Berwin & Co. 1999; Monteiro and Shah 2000; Zukis 1997). These reforms have tried to reduce the tax burden for an employee receiving options and may have stimulated the use of options (International Tax Review 1999; Eswick 2001; Zukis 1997). If this is correct, further reform in other countries along similar lines should stimulate the adoption of stock options elsewhere.

Some evidence suggests that restructuring the tax treatment of stock

27 Spain is an exception to the typical pattern since there has been tax reform recently but this did not liberalize the relevant rules: Delaney and Wessel (1999).
options may not have much effect. Using data for 1984 to 1992, Abowd and Boganno (1995, pp. 92–5) examined the tax treatment of stock options in 12 countries to see whether differences in the relevant tax rules were correlated with the popularity of stock-based incentive pay. They concluded that tax treatment of stock options did not explain the balance between stock options and other forms of pay.

However, this study did not take into account the tax consequences for the corporation granting the options. In the United States, gains executives receive from exercising stock options are typically deductible from corporate profits as an ordinary business expense (Conyon and Murphy 2000; Hall and Liebman 2000). This means that when a CEO exercises stock options, the corporation receives a tax deduction equal to the difference between the market price of the stock and the exercise price of the option.

Moreover, Bernhardt (1999) notes that in other countries, such as the UK, companies generally cannot deduct gains executives receive from exercising share options because no out-of-pocket expense is incurred. Conyon and Murphy (2000) suggest that this difference in tax treatment between the US and UK may account in part for the greater popularity of executive share options in America. Perplexingly, empirical evidence suggests that US corporations which cannot gain much benefit from the gains realized by executives exercising stock options appear to use this form of compensation in much the same fashion as other firms (Hall and Liebman 2000, pp. 18–20). From this discussion, it appears that tax rules may have little effect on executive compensation choices.

The role of the tax law on executive compensation was highlighted in 1993, when the US government changed its tax code to limit the deductibility for corporations of executive compensation over $1 million annually unless any additional compensation was performance related (Murphy 1995). Subsequent analysis by Hall and Liebman (2000, pp. 22–4) indicates that this tax code change had little effect on the rate of growth of executive pay and only led to small shifts toward pay for performance. This suggests that corporate tax policies have had little impact on whatever globalization trends might exist in the area of executive compensation.

B Labor law

Outside the US there is a potential legal pitfall for pay for performance plans: labor laws creating so-called ‘acquired rights’. In countries recognizing the acquired rights concept, payments that are made on a recurrent basis to an executive can, over time, be transformed into an entitlement to receive stock option compensation, or other forms of long-term incentive pay that are intended to be awarded conditional upon
satisfaction of criteria related to corporate performance (Parker-Pope 1995; Tischendorf 1999). The creation of such an entitlement would make companies more reluctant to award performance-based pay because it would lose its incentive features and become a fixed component of executive pay. In sum, acquired rights laws could deter the adoption of pay-for-performance executive compensation, a fact duly noted in Towers Perrin (2005a) as having an ‘increasingly important’ impact in the European Union countries.

However, the effects of acquired rights legislation should not be overstated. In Germany, a grant of stock options, or other incentive-oriented pay, can be deemed an acquired right if, because of the constant repetition of such an award, the employee can reasonably conclude that it is granted to him in perpetuity. However, companies routinely stop this from occurring in two ways: first, by adding a requirement to the employee’s employment contract that all changes must be made in writing, and second, by clearly stating in the employment contract that the compensation is given on a voluntary basis.

Moreover, according to Gates and Reid (1994), only some countries consider stock option plans to constitute an entitlement under acquired rights legislation. Leander (1998) argues that even where acquired rights regulations do apply to incentive-oriented pay arrangements, they may have little impact. For example, in Brazil during the 1990s, performance-oriented pay grew substantially in popularity because the Brazilian subsidiaries of some multinational companies began offering variable bonus plans to bolster their recruitment of local managerial talent. To assist local firms in retaining their workers, Brazil’s Labor Ministry expressly authorized domestic companies to use variable pay based on corporate performance, effectively overruling acquired rights laws (Towers Perrin 2005a).

7 ‘Soft law’

‘Soft law’, or the rules and guidelines directed at corporations promulgated by private organizations rather than by legislatures, government regulators, or judges, can have an important impact on internationally oriented corporations (Branson 2000). This definition of soft law includes standards promulgated pursuant to a statutory mandate, so that it covers accounting standards in the US developed by the privately organized Financial Accounting Standards Board (FASB), even though the FASB is exercising powers delegated to it by the SEC (Cheffin 1997a). It also includes the listing rules that apply to corporations traded on the New York Stock Exchange (NYSE) and NASDAQ. Both the listing standards and the accounting rules are soft law, despite the fact that the SEC has the power to veto, or amend, any existing or proposed regulations, because
the relevant stock exchanges and the FASB formulate and enforce these standards (Karmel 2001, pp. 325, 339).

Soft law affects executive pay plans in several different ways. For instance, with few exceptions, in the US, the listing rules of the NYSE and NASDAQ require listed companies to obtain shareholder approval before introducing a stock option plan (Wagner and Wagner 1997). In Australia, New Zealand, Hong Kong and Singapore, stock exchange listing rules require a shareholder vote if an employee incentive plan will award securities to corporate directors.

Accounting soft law standards can require disclosures about managerial compensation as well. For instance, for many years in the US, stock options received favorable accounting treatment under FASB guidelines (Bebchuk et al. 2002). At that time, a corporation that awarded stock options without performance conditions attached had the option of not reducing its earnings to reflect the cost (Sirkin and Cagney 1996; Stabile 2001b). As a result, many commentators claimed that US accounting rules created a preference for stock options (Murphy 1998, pp. 2514–15; Morrison 2000; Leonhardt 2000). However, the FASB recently ruled that employee stock options are a compensation expense that must be included on a company’s income statement. As a result, there is no longer any accounting advantage to using stock options instead of other forms of compensation.

Accounting standards cannot explain why stock options are more popular in the US than they are in other countries though. For one thing, not all countries have such standards – Germany only established an independent accounting standard setter in 1998 for example – and even many countries with well-established accounting standards do not require expensing of stock options.28 Other factors must account for the unique popularity of stock options in America.

Soft law can provide guidelines for the determination of executive pay, such as those created in various corporate governance codes promulgated in recent years. These codes, often drafted by committees of business leaders and/or stock market officials (Cheffins 2000a; Noburn et al. 2000), quite often contain guidelines about setting executive pay. In Sweden, for instance, the Swedish Code of Corporate Governance was created by business representatives and made a part of the listing agreement for companies traded on the Stockholm Stock Exchange. It requires the establishment of a remuneration committee, which must prepare recommendations for senior management’s pay to be presented for a vote at the shareholders’

28 Id. (Germany); Barker and Peel (2000), p. 27 (UK); McClearn (2000), p. 63 (Canada); Paterson (2000), p. 102 (UK).
meeting. Their proposal is posted on the company’s website, and includes such information as the principal terms of bonus and incentive schemes, the variable components’ relative importance to the fixed components, and how these components are linked to firm performance. The effect of the Code has been ‘positive but not dramatic’ (Heidrick & Struggles 2007).

The most ambitious arrangement of this type was originally developed in the UK. The Greenbury Committee’s 1995 Code of Best Practice, backed by the London Stock Exchange, spelled out how executive pay packages should be configured (Cheffins 1997c). As a result, listed companies were instructed to avoid paying more than was necessary to hire talented executives, and given detailed guidance on the design of performance-related compensation. The current version of the listing rules, now administered by the Financial Services Authority, contains a somewhat modified version of the Greenbury Code guidelines in an appendix referred to as the Combined Code. Although listed companies were not obliged to comply with the Greenbury Report’s recommendations, only to disclose whether or not they conformed with its standards (Cheffins 1997c), nevertheless there is substantial compliance overall. In this indirect manner then, soft law guidelines on executive pay have had an influence on the configuration of managerial pay.

Outside the UK, it is less clear that soft law has had a significant impact on executive pay for several reasons. First, in some jurisdictions, compliance with the corporate governance code is purely voluntary because the code does not have the additional strength from stock market listing rules, or securities regulations (Cheffins 2000a; Gregory 2000). Second, many codes provide little detailed and specific guidance save for a few hortatory sentences emphasizing the need to link pay with performance. This type of soft law is unlikely to have a significant impact on executive pay.

8 Culture
Licht (2001) observes that culture is a notoriously difficult concept to define with any precision. However, the term surfaces frequently in compensation consultants’ work as an explanation for why international compensation levels and practices vary so substantially (Robertson 2000, pp. 603, 606–7; Conyon and Murphy 2000). As a result, culture, which Deresky (2000) notes can be defined as a society’s shared values, understandings and assumptions, is an important variable to consider when analyzing executive pay.

One major theme in the literature is that cultural differences explain the

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29 The Swedish Code of Corporate Governance 2005, section 4.2.2.
wide gap between American CEOs’ pay and that of top executives in other countries (Henzler 1992, pp. 57, 60). The underlying assumption behind this claim is that Americans are more tolerant of income inequality that is perceived to arise out of differences in ‘effort, talent or entrepreneurial risk taking’ (Conyon and Murphy 2000). Despite considerable criticism of CEO pay levels (see Stabile 2000), ultimately the US accepts the need for high pay for performance executive pay (Cox 2000; Crawford 1994; Slade 1997). By contrast, Fung (1999) and Parker-Pope (1995) observe that, in other countries, strong egalitarianism leads to the rejection of the notion of high CEO pay, and to avoid conspicuous displays of wealth. This is true even in the UK and Canada (Crawford 1994), which supposedly have adopted the American business culture (Conyon and Murphy 2000; Vander Weyer 1998; Crawford 1994). In Australia, similar arguments have been made to explain comparatively modest managerial pay arrangements in that country (Slade 1997). If culture is important, it could potentially act as a check against American-style executive pay levels in other countries.

Germany and the Mannesmann case are very good examples. In those proceedings, Germany’s highest appellate court referred to local compensation norms in rejecting the need for a special payment to top executives, noting: ‘The size of the special payment for the accused Dr. Esser, which was uncommon for the German business locale . . .’.30 As further proof that parochialism remains an important consideration in CEO pay, Nakazato et al. (2006) found that Japanese CEOs earn one-third as much as their US counterparts. However, they also found that executive pay in Japan is not dependent on accounting profitability or stock returns. Thus, in Continental Europe and Japan, self-restraint by executives against high pay may lead those who run companies to limit their compensation demands.

Violations of this self-restraint can lead to public uproar. For example, in 2007, the German public was shocked at the revelation that Wendelin Wiedeking, the CEO of Porsche AG, had earned approximately $90 million in the previous year (Esterl 2008). The company, however, was unapologetic because when Wiedeking’s employment contract was negotiated in the early 1990s, Porsche was in serious financial distress. Wiedeking turned the company around, and as a reward the controlling shareholders voted to give him a 0.9 percent share of the firm’s profits. While no one contemplated what that might mean in the event of record profits, the company’s current chairman said that Wiedeking is ‘worth every Euro’. (Hawranek et al. 2007). This revelation could have major policy consequences because of strong worker resentment of large pay inequities within society (Esterl

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2008). This example illustrates both the importance of the equalitarian norm, and its limitations as a check on executive pay.

Sweden is another important example of how a strong egalitarian culture can have an important effect on CEO pay (Oxelheim and Randøy 2005; Högfeldt 2005, p. 19). After an intense debate in the Swedish media about the ‘unreasonably high’ compensation given to certain executives, and its seeming lack of connection to the companies’ results, the Swedish government set up the special committee that ultimately determined it to be in everyone’s interest that executives’ remuneration is reasonable in relation to a company’s result and growth.31 Even the Confederation of Swedish Enterprise, an organization of prominent business members, stated in issuing their influential guidelines for the remuneration of company directors and senior management personnel in 2004 that ‘the debate has chiefly centred on the remuneration of managers of the very largest listed companies, where the amounts have been considered at times to be excessive and hard to explain. In certain cases, completely unreasonable levels of remuneration have been paid that – justifiably – have been condemned and that have undermined confidence in the business community’.32

Similarly, in China, ‘there has been public unrest about the increasing compensation of executives at listed firms. The State-owned Assets Supervision and Administration Commission (SASAC), which is a government unit that administers much of the state’s stockholding in listed firms, has recently announced plans to investigate the salary increases of senior executives of state controlled listed firms’ (Firth et al. 2007)

Different corporate objective functions may also lead to different compensation approaches. For example, in Continental Europe and many market-oriented economies in Asia, managers are seen as trustees who act on behalf of all corporate constituencies, only one of which is shareholders (Dore 1997, pp. 35, 42–3, 47; Henzler 1992, pp. 60–61). Cheffins (2001) notes that large pay for performance-oriented compensation packages might lead corporate management to promote shareholder interests at the expense of other stakeholders, which would undermine these firms’ stakeholder approach. As a result, Cheffins (2001) suggests that these companies may be reluctant to move strongly in the direction of adopting pay for performance for their executives.

Social resistance to high pay is another important concern that may lead to corporate self-discipline if there are reputation costs for the firm’s

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31 Proposition (Prop.) 2005/06:186 Ersättning till ledande befattningshavare i näringslivet, at 27 (government bill) (Sweden).
32 The Confederation of Swedish Enterprise (2004), p. 3.
directors when they authorize large contracts (Cheffins 1997a, p. 699; Bebchuk et al. 2002; Brummer 1996). Directors may be more reluctant to approve, and CEOs slow to ask for, pay packages viewed as outside the social norm (Bebchuk et al. 2002). For an example of this process, see Parker-Pope (1995).

Social pressure may also function as a catalyst for legislative reform. As mentioned earlier, the US tax code was amended to exclude deductions for managerial pay over $1 million in response to public pressure. Similarly, in the UK, growing disquiet over executive pay motivated the UK’s Greenbury Committee to tackle executive pay and thereby avoid tough statutory regulation (Cheffins 1997a, pp. 655–6).

Cultural values can evolve, though, thereby creating scope for change in executive pay practices. This certainly seems to have been the case in the UK. Up through the 1970s, top British executives were paid less well than their counterparts in all other major industrial countries (Parker 1976), perhaps because the British managerial culture was very egalitarian and UK firms reflected this in their pay structures (Lane 1989, pp. 131–2; Budde et al. 1982). However, throughout the 1980s, Britain’s political scene shifted dramatically, as its ruling Conservative party espoused strong free-market ideologies. Coincident with this political and cultural shift there were dramatic increases in executive compensation. The gross pay of CEOs in large, publicly traded UK firms rose nearly 600 percent between 1979 and 1994 (Goodhart 1994). According to Abowd and Kaplan (1999), by the mid-1990s, British CEOs were among the best paid in the world.

On the other hand, substantial increases in CEO pay have largely failed to materialize in Japan. Gabaix and Landier (2008) observe that in the 1980s, firm values and CEO pay in the US sprang upward in unison. During the same period, the value of Japanese firms also grew significantly, but Japanese CEOs’ pay did not rise proportionally. The dynamic nature of cultural trends, however, makes it hard to project whether these movements will continue or reverse themselves over time.

9 Conclusion
Top executives, especially CEOs, at US firms are better paid than their counterparts in other countries. In large part for this reason, management compensation has been controversial in the US, and to a lesser extent, the UK, which most closely follows American practices. Executive pay has attracted less attention in other countries for the most part (Andre 1998), save perhaps in Canada and Australia (Clegg 1999), again most likely because levels have been much lower.

Are American pay practices spreading throughout the world? Several factors point in this direction: wider dispersion of share ownership, more
cross-border hiring of executives, growing international M&A activity and the expansion of business activity by multinationals. Although it is hard to know how influential these factors will be over time, any shift towards higher pay levels, and more pay for performance, is likely to lead to vigorous debate in the countries affected, especially those with strong egalitarian tendencies. (For examples of where this has already occurred to a certain extent, see Gow and Milner 1995; Graham 2001.)

What is the likely reaction of policymakers in these countries? One possibility is that the shift will be encouraged, perhaps because domestic companies will need to ensure that they do not lose their top managerial talent. Alternatively, increased levels of pay for performance might be defended as necessary to encourage greater shareholder investment through closer alignment of managerial and investor interests (Brull 1995; Kay 1998; *Asian Wall Street Journal* 1999).

Of course, the American approach has plenty of critics. Managerial rent extraction theorists, including Bebchuk et al. (2002), claim the system is strongly biased in favor of executives. Heavy use of stock options can also create incentives for managers to artificially inflate stock prices. High executive earnings could adversely impact the morale of rank-and-file employees and lead to productivity drops. And in some nations with strong traditions of relatively equal distribution of income, a widening pay gap between those at the top and those on the lower rungs of the corporate ladder could cause serious political repercussions.

For those favoring a more Americanized system of executive pay, some policy options seem unlikely to produce the desired outcome. For example, implementing corporate laws intended to directly regulate executive pay, strengthening directors’ fiduciary duties and courts’ ability to police those duties, or imposing new shareholder voting requirements, seem unlikely to yield the desired outcome.

One option for these policymakers may be to simply let market forces lead pay levels and composition to their equilibrium position and to focus on removing as many legal obstacles as possible from their path. Introducing stronger disclosure requirements might also be prudent, because giving shareholders additional information may permit them to press harder for greater pay for performance linkages. It might also cause a ratchet effect in executive pay that may be needed to compensate executives for the greater risk attached to their pay.

Another policy intervention that could lead to higher pay for performance levels would be to reduce control shareholding concentrations. Countries encourage such movement by strengthening protections for minority shareholders. While there are no guarantees this will succeed, it may lead to at least a partial shift in executive pay practices.
On the other side of the policy debate, those seeking to hold down CEO pay levels and discourage the use of pay for performance, should not count on soft law guidelines to do the job. The UK experience with the Greenbury Committee is instructive. Despite quite detailed guidance, managerial compensation levels rose substantially in UK companies in the years that followed (Arthur 2000; Thornton 2000).

Increases in the top marginal income tax rate seem more likely to directly reduce executive pay levels because executives keep less of what they earned and will therefore be unlikely to seek large pay increases. This presupposes that such increases are politically feasible though, which requires that social concerns about high executive pay are very strong.

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