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Linking pay to performance:  
A closer look at performance-based compensation  
and shareholder voting rights

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## 1. INTRODUCTION

Shareholders and managers of a modern firm have differing interests. It is difficult for shareholders to perfectly perceive investment opportunities and managers' actions (Jensen and Murphy, 1990). Actions taken by managers – though not easily observable by shareholders - may have a significant impact on shareholders' wealth (Aggarwal and Samwick, 1999b). Therefore, it should be a goal for shareholders to improve monitoring, motivate their managers and give them incentives to execute their actions wisely. Predicted by agency theory, shareholders should design compensation contracts for their managers, whereby shareholders' wealth can also increase if the expected costs associated to managerial actions are less than the expected returns.

One possible way to induce executives to operate in the best interest of their shareholders is to link managerial compensation to company performance. This would tie managerial welfare to shareholder wealth.<sup>1</sup> Holding options on the company's stock is one method of correlating a manager's compensation with shareholder returns (Aggarwal and Samwick, 1999a). According to Antle and Smith (1986), this method can help align the objectives of managers with shareholders. If a manager is risk averse, Aggarwal and Samwick (1999b) point out that the usefulness of such an act depends on the effect of external industry shocks to a company's performance.

Basing a manager's pay only on his individual performance gives him incentives to be productive. However, his individual observed and measured performance (and thus his compensation) is affected by industry shocks (i.e. random factors, which are beyond his control). If these common industry shocks are correlated across various companies in an industry, it might be a good instrument to let the manager's compensation depend on the performance of his company relative to the performance of other companies in the specific industry. This approach is commonly known as relative performance evaluation (RPE). When evaluating different types of managerial compensation, the RPE hypothesis indicates that companies should

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<sup>1</sup> As pointed out by Aggarwal and Samwick (1999a), there are other ways to induce managers to act in the interest of shareholders: for example competitive labor markets or the threat of dismissal and takeover.

compare the firm's own performance to that of a relevant peer group (Holmström, 1982). Random industry factors that have an influence on a manager's performance often affect the observed performance of other managers in the same company, industry or market as well (Gibbons and Murphy, 1990). By allocating a positive weight to the performance of the company of interest and negative weights to the performance of other firms within the industry, the common industry shock is filtered out. This typical procedure for an RPE contract implies that an executive's pay decreases if managers of other companies in the industry distribute higher returns to their shareholders (Aggarwal and Samwick, 1999b).

Performance-based compensation plans for inducing executives to choose actions that increase shareholder wealth have come under scrutiny since the onset of the global economic crisis (Bernard and Courtois, 2012). The careful calculation of remuneration is now on the agenda of many shareholder meetings. However, absolute increases in CEO pay are not the largest problem, with the design of CEO contracts also being crucial (Jensen and Murphy, 1990a).

There has always been a strong link between times of economic crisis and increased regulation on executive pay. As a result of the recent financial crisis, governments around the world are proposing laws to regulate the remuneration of financial executives. The aim of those proposals is to better align remuneration practices with shareholders' interests and promoting the stability of companies and the financial system (Core and Guay, 2010).

From 2009 onwards, federal proposals related not only to executive compensation, but also to shareholder empowerment (Hill, 2011). In 2002, the UK proposed a mandatory say-on-pay vote within all publicly traded companies, i.e. shareholders can cast a non-binding annual vote on the chief executive's compensation package. In other words, companies are able to receive feedback on their remuneration structure but are not forced to act upon the proposed changes by shareholders. Other countries in the European Union followed, and in 2010, President Obama finally signed the Dodd-Frank Wall Street Reform and Consumer Protection Act, letting investors in the US have a say on their executives' pay. Shareholder voting rights might not be a "one-size-fits-all" answer, but it does place some degree of pressure on companies and on boards of directors or compensation committees to look more carefully at executive remuneration packages. Countries



such as Canada, where firms permit their shareholders to conduct voluntary say-on-pay votes (as there has been until now no governmental requirement for such voting), report mostly positive feedback on improved cooperation between shareholders and executives. In Switzerland, however, there has been an emerging debate regarding say-on-pay. A proposed referendum should determine whether a say-on-pay vote will be binding for all Swiss publicly traded companies, with a national vote expected to occur at the end of 2012 or at the beginning of 2013. A result whereby the majority of voters are in favor of say-on-pay voting would result in Switzerland adopting one of the most extreme forms of shareholder voting rights.

This thesis is organized as follows. Chapter 2 provides a review of agency theory, managerial incentive problems and moral hazard. Chapter 3 illustrates the structure of executive compensation contracts. In addition, the associated benefits and disadvantages of performance-based remuneration packages are presented. Chapter 4 discusses the implications of the global financial crisis on executive compensation and the introduction of shareholder voting rights. A classification of different approaches of say-on-pay votes as well as consequences for companies in the UK, the US and Switzerland are presented. Chapter 5 concludes and gives a short outlook on future investigations.

## **2. MANAGERIAL POWER AND AGENCY COSTS**

### **2.1. Agency theory**

Various agents play a role in agency theory: managers, shareholders, the board of directors, and other stakeholders such as the government, suppliers, and customers. Each player has a very specific interest to pursue that might involve a cost. Agency theory takes place in all organizations and at every level of management within the organization. As the information asymmetry between the manager and the shareholder of a firm is considered to be the classic example of the principal-agent problem, the following discussion focuses on this concept.

In the beginning of the last century, corporate executives had substantial power and almost complete discretion in management (Berle and Means, 1932). The term “agency problem” first arose in the 1970s, at a time when research focused on the theory of interaction between managers and shareholders and its impacts on stakeholders. The term refers to the problem of different interests of managers and shareholders, describing the conflicts, which can arise from this relationship (Jensen and Meckling, 1976). Since then, the problem of managerial power and discretion has been analyzed in modern finance.

An agency problem arises when a principal who owns a firm engages an agent (i.e. a manager) to perform some services on the owner’s behalf. Therefore, the owner of the company has to delegate some decision-making authority to the agent, i.e. he assigns the control of ownership to the agent (Müller, 2011). The act of delegating does not constitute a problem by itself, however managers and owners often try to fulfill their own interests and maximize personal welfare (Jensen and Meckling, 1976). Therefore, maximizing firm value may be in the best interest of the principal, but not the main objective for agents. Typically, a principal-agent problem involves two different types of risk exposure: principals are risk-neutral, whereas agents are risk averse. Principals can diversify their risk by holding a number of different firms in their portfolios, whereas an agent only has one profession (Müller, 2011). The principal-agent problem takes place because of informational asymmetry. If one of the parties is utility maximizing, he will not act in the best interest of the other and therefore he does not have an incentive to represent the other’s interest.

Therefore it is not possible for the owner to ensure that the agent only takes actions, which are in the principal's interest, without being exposed to agency costs (Jensen and Meckling, 1976).<sup>2</sup>

In order to ensure that managers create value not only for themselves, but also for shareholders, two basic approaches are known for overcoming the so-called "agency problem": (1) monitoring or controlling the agent and (2) managerial incentive compensation. While the board of directors usually acts as a "monitor" of a company's management on behalf of its shareholders, incentive compensation tries to encourage the manager to maximize the value of the firm and of its shareholders (Jensen and Meckling, 1976).

Generally, shareholders of a large company are too diffuse and uninformed to directly control management efficiently. Therefore, shareholders are seen as a relatively powerless group providing capital to the company. Although the board of directors tries to monitor the relatively small group of management that uses the capital on behalf of a typically large group of shareholders, in practice the board of directors acts solely as a proxy of shareholders and their provided capital. Thus, the board may not act with the same efficacy in regards to shareholder capital as a capital owner may do. As a result, even the best board of directors may sometimes fail to control management and their behavior. Boards are therefore often criticized for not being able to monitor existing management as efficiently as shareholders wish them to in order to maximize firm value (Jensen and Meckling, 1976). In addition, monitoring may be very costly for the principal, as the manager typically has a more efficient mechanism to serve as a perfect monitor (Müller, 2011).

Aware of the above-described problem of monitoring or controlling, the second approach, managerial incentive compensation, seems to overcome the first approach and directly measures a manager's success by linking the manager's remuneration to a company's performance (Jensen and Meckling, 1976).

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<sup>2</sup> The costs related to this issue are referred as monitoring costs (imposed to the principal) or bonding costs (by the agent) (Müller, 2011).

## **2.2. The moral hazard problem**

Generally, moral hazard is related to asymmetry of information among individuals. Within a modern firm, the relationship between shareholders and managers is often characterized by this problem. Moral hazard is the consequence of not being able to observe individual actions. Therefore, the principal of the company cannot include unobservable managerial actions in the CEO compensation contract and shareholder monitoring of managerial actions would seem to be the best solution to this problem. However, it is possible that the costs resulting from managerial monitoring rise significantly or that monitoring is impossible due to complex situations within a company. In such cases, the imperfect estimation of managers' actions is often used in practice to reduce moral hazard (Holmström, 1979).

Due to absence of the role of information in previous economic theory, the development of an economic theory based on the absence of a world of perfect information (known as the informativeness principle) was necessary. The incentive problem originates from an asymmetry of information among individuals. A possible solution is to monitor managerial actions and include the information, i.e. informative signals, which are provided through any measure of performance in the compensation contract of executives (Celentani and Loveira, 2004, Holmström, 1979). It is important for shareholders to reveal the information about the manager's choice of actions, as they are unobservable to the principal. This problem can be analyzed in a single-agent or in a multiple-agent setting.

The behavior of a party is influenced by whether the party is fully exposed to the risks following their actions or not. It is obvious that parties that do not bear the consequences of their actions take on more risk than others. This dilemma is referred to as the 'moral hazard problem' in scientific literature. Using the example of an organization, one can see that the moral hazard problem lies in the relationship between the principal and the agent. Within a multiple-agent setting, moral hazard is seen as the problem where agents, having more information than the principal, behave differently when their actions cannot be perfectly monitored (Holmström, 1982).

Relative performance evaluation as a means of resolving the moral hazard problem can provide two essential features of multi-agent organizations: the free-rider problem and competition.<sup>3</sup>

Under certainty, a model of team production where the agents do not behave cooperatively can be assumed. The full joint output should be distributed fairly between the agents. The non-cooperative game should yield a Nash equilibrium, which is in conflict with the budget-balancing restriction.<sup>4</sup> Therefore no sharing rules can be created which satisfy both agents. This in turn means that improper actions of agents do not lead to a fair proportion of the output and that the behavior of all agents always leads to an inefficient outcome. Since all agents cannot be penalized equally and sufficiently, there exists an incentive for an agent to deviate from optimal effort<sup>5</sup>. To assure the sufficient effort of all agents, shareholders should focus on monitoring their behavior (Holmström, 1982, Alchian and Demsetz, 1972).

From another perspective, the problem of free-riding is due to the inability of observing managerial actions and simultaneously imposing budget-balancing constraints. When relaxing the budget-balancing assumption, an efficient Nash equilibrium exists. One possibility of changing the budget-balancing condition is to use group bonus systems and enable penalties to influence the behavior of all agents. Only if the group outcome is larger than the efficient Nash equilibrium will a bonus be rewarded, otherwise penalties will be permitted. In order to monitor the agents in a correct way, a principal who does not provide any inputs has to be hired by the firm to administer incentive systems otherwise the free-rider problem continues. The introduction of group bonuses and penalties motivates the agents to achieve the goals set by the bonus system since they do not have any information if the other parties have not put enough effort into their work (Holmström, 1982).

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<sup>3</sup> The term “free-riders” refers to agents who get more than their fair share of output if the combined output is the only observable parameter; in other words, one agent may put less effort and time in his work and still get the same part of the amount produced.

<sup>4</sup> A Nash equilibrium is named after the mathematician John Nash and is a set of strategies, where neither player has an incentive to change unilaterally his strategy.

<sup>5</sup> For example, in small organizations or partnerships, the free-rider problem induces agents to put less effort into their work.

Given that agents operate under uncertainty, group penalties will work as well under the condition that a penalty is created, which reduces each agent's output if a specific, critical output level is not achieved. Concluding this discussion, one can state that by introducing bonus or penalty systems, efficient team production will be reached (Holmström, 1982).

These theorems provide evidence for the fact that companies create schemes to decompose joint output into the single contributions of agents. The total output is assumed as a sum over all individual outputs created by agents, which are dependent on their single actions and external effects. If these externalities are independent on each other, the optimal sharing rule of each agent only depends on the agent's output. However, if they are dependent, the sharing rule of each agent should depend on the output of all agents. In other words, the agents compete with each other and are evaluated on the basis of their relative performance (Holmström, 1982).

In order to make individual uncertainty independent from total output, measures like weighted average of peer performance are necessary, since they screen all information about common uncertainty. The optimal sharing rules are only dependent on the weighted average and the individual output. With this method one can easily filter out the effect of common uncertainties, so that the single agent is only responsible for his individual uncertainty and output. This theorem provides a good reason for comparing the performance of single agents against peer averages. In other words, it is a good idea to link compensation of agents to the company's performance in relation to other companies in the same industry. Such a practice became popular in 1980s (Gibbons and Murphy, 1990, Jensen and Murphy, 1990a, Jensen and Murphy, 1990b).<sup>6</sup>

For validity of this model the assumption of shareholders knowing managerial utility functions and outcome distributions of each of the agent's actions is necessary, which is not likely to occur in the real world. Moreover, basing CEO compensation not only on variables that increase shareholder wealth, but also on those that reveal some information about managerial actions, creates the danger of providing incentives to the manager to put effort into actions that do not increase shareholder

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<sup>6</sup> Especially the decrease of stock options (as they lost their tax advantage) made relative performance measures popular (Holmström, 1982).

wealth and firm performance. In contrast, this may create incentives to disregard projects with large net present values in order to devote effort to those projects that are less valuable but provide more information for shareholders (Gibbons and Murphy, 1990, Jensen and Murphy, 1990a, Jensen and Murphy, 1990b).

### **2.3. Incentive effects of executive compensation**

If shareholders do not have perfect information about their agents, they may pursue different interests. Agents know their own talents and adjust their effort levels accordingly. Furthermore, shareholders try to maximize profits, however they do not have information on agents' abilities. Firm output depends only on the work levels and not on the abilities of agents (Mirrless, 1976).

Agents choose their working level in order to maximize their utility function, which depends on their payment schedule, work and talents. Any changes in the payment schedule changes the chosen work level and thus the outcome of the company. Generally, the firm can only employ and retain agents if they at least pay wages to reach to fulfill a certain utility level of the agents. This certain utility level is the one available to the agents at other firms, i.e. if the firm pays less, agents will leave the firm for another company. Each agent is on a pay schedule that is equal to the marginal product an agent produces in equilibrium<sup>7</sup>. In the case of a given labor force, under the condition that the payment schedule of a worker is equal to its marginal product, the utility function of that worker will be greater or equal to the average utility function of all competitors in the market. Thus, the wage for an agent will be less than or equal to marginal product. Generally, paying an agent more than his marginal product only occurs if there are special circumstances (Mirrless, 1976).

Under competitive conditions and with equal production schemes among all firms, equilibrium can be reached if the payment schedule is equal to the marginal product of an agent. If a firm pays an agent more than his marginal product, the firm can maximize its profits by paying less and risking losing that agent, given that the

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<sup>7</sup> If the company pays the worker more than he produces, the worker is not valuable for the company. In contrary, if the company pays the worker less than he produces, the worker will no longer work with the company, as his utility function is higher with another firm.

change in work level does not lead to a great change in marginal productivity (Mirrless, 1976).

In an imperfect labor market it is important to take incentive and disincentive effects into account when determining pay structures. The difference between the wage and the marginal product of a highly skilled agent should be much larger than that for an unskilled agent. As the labor market demand becomes more inelastic for higher skilled agents, firms can pay less than the marginal product produced by the agent (Mirrless, 1976).



### **3. CREATING INCENTIVES FOR CEOs**

#### **3.1. Structure of executive remuneration contracts**

In general, compensation contracts for executives should comprise those elements which accomplish the following issues: attract and retain the right managers at low costs, encourage them to leave the company if the time is appropriate and finally encourage them to take the effort to increase firm value and avoid taking actions which destroy shareholder value (Jensen and Murphy, 2004).

Furthermore, there are three dimensions, which should be taken into consideration for designing compensation contracts: total benefits of the job, the structure of compensation packages and the pay-performance relation. All three dimensions should be managed by directors of a company or a specific compensation committee, ordered by the board of directors (Jensen and Murphy, 2004).

The remuneration package of top executive managers is usually made up of four elements: base salary, short-term compensation (including annual bonuses), long-term incentives and options. Further components of a CEO's pay package may include retirement plans or restricted stock.

##### **3.1.1. Base salary**

Until the 2000s, cash remuneration represented the main and substantial part of CEOs' remuneration. One has to bear in mind that industry and market peers play an important role in the design of base salary contracts of executives as the competition within the same sector often acts a guideline, especially for new firms. Comparisons with other firms within the industry are normally adjusted for company size, highlighting the link between CEO remuneration and firm size. This sort of determining base salaries of CEOs is known as "competitive benchmarking" in financial literature (Pope and Young, 2004). The authors also state that CEO salaries do not normally take into account dimensions such as age, experience, education, performance or job complexity.

### **3.1.2. Short-term compensation and annual bonuses**

The annual bonus component of a manager's remuneration is typically tied to a company's performance, with a one-year time period often taken as a reference point. According to the associated literature, bonus plans can be categorized in terms of three basic components: performance measures, performance standards or targets, as well as pay-performance structures (Jensen and Murphy, 2004).<sup>8</sup>

Researchers in the field of Finance stress that the use of accounting numbers as a basis for calculating the annual bonus is advisable as they are widely used, often verifiable and are understandable to outsiders. Moreover, managers precisely know how their actions will affect year-end profits and they are provided with the information on how they can boost shareholder value. Therefore, managers know the value drivers and creators in their organizations, thus having better incentives to conduct their day-to-day projects with more effort and motivation (Jensen and Murphy, 2004). However, there are also some drawbacks to this method, which have consequences for measuring company performance. First of all, accounting numbers are always backward looking, which implies that managers do everything to "look best" in the past, but would not show that much effort for future projects. Secondly, accounting data may be subject to manipulation. Research in executive compensation shows that CEOs are deploying creative accounting techniques to maximize the value of their bonuses over time and engage in unethical behavior (Jensen and Murphy, 2004).

The most commonly used payout schedule and traditional bonus plan is known as the '80/120 bonus plan', whereby bonuses will be paid out only if the manager reaches a target range of 80%-120%.<sup>9</sup> Under this 'typical' bonus plan no bonus will be paid unless a certain percentage of the target performance is achieved (i.e. 80%) and the bonus will be capped at a certain percentage again (i.e. 120%). The incentive zone labels the interval of performance where bonuses are paid and an incremental raise in performance signifies an incremental raise in bonuses. This bonus plan is commonly and widely used among smaller and also larger companies as it provides an incentive zone for managers to reach. The benefit of such a plan is

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<sup>8</sup> See Appendix – Figure I for an illustration of the basic components for a typical bonus plan.

<sup>9</sup> The chart in Appendix – Figure I illustrates a typical 80/120 bonus plan.

that pay-performance relation can be seen and measured easily. Managers are also encouraged to work hard and efficiently in order to receive the annual bonus.

However, despite the mentioned gains such bonus plans may entail, a big disadvantage is the process of 'capping' the bonus. Reaching the maximum payout suggests to the manager that his work for that period is 'done' and no rewards are given for higher performance. Instead, managerial effort is exerted in greater supply in the next year and the company may not record any higher profits in the coming year, as compared to the previous period. Another disadvantage of a capped bonus plan is the fact that poor performance only affects the current year bonus. This case may be problematic for a company at a point in time where managers recognize that they will not be able to meet the target for that period, shifting revenues to the following period and expenses from future years to the current year. The reason for this shifting lies in the fact that it costs the managers nothing to behave that way in this period, however for the next period it is more easy to reach the pre-specified targets (Jensen, 2003). It can be stated that the annual renegotiation does not tie executives' wealth to the company's sustained value. Moreover, managers always try to set targets that are easily reachable making it more realistic to receive a bonus.

Typically, short-term pay packages are paid out to chief executives through cash awards. Normally, they are characterized as having only a one-year performance measurement term. Standard accounting measures of short-term compensation plans include an increase in net income, return on equity or return on assets. Short-term pay plans are offered to those managers who are able to influence the short-term performance of a company. Firms adopt this kind of compensation scheme to overcome incentive problems like risk-aversion or the horizon problem (Tehrani and Waagele, 1984).

### ***3.1.3. Long-term compensation and options***

As companies have seen over time that annual bonus systems are focused on the short-term and thus do not often yield the expected result (i.e. an increase in firm performance), long-term incentive plans have been given generously to managers. These structures are planned to encourage executives to focus on firm performance over a longer period of time. Long-term incentives can take many forms, of which grants of shares are the most common in European countries (Pope and Young

2004). These grants are only paid out if certain performance objectives are met. Like annual bonuses, long-term incentives are often based on accounting numbers, where earnings per share (EPS)<sup>10</sup> and total shareholder return (TSR)<sup>11</sup> are the most common ones. Additionally, these measures are set relative to another standard or percentage. This may signify that a manager will only get pre-specified long-term incentives if the growth of the company's earnings per share reaches a certain level.

There are several basic remuneration schemes of long-term pay plans: (1) stock options, (2) stock appreciation rights, (3) phantom stock, (4) dividend units, (5) restricted stock, (6) performance packages (Tehrani and Waagele, 1984). Short- and long-term remuneration plans differ by their length of measurement period. Long-term compensation schemes are characterized by being measured by the rise of the share price or increase in earnings over several years. Usually, the manager is not paid in cash but rather by shares of stock (Tehrani and Waagele, 1984).

Stock options are the most common type of equity-based compensation and give the recipient the right but not the obligation to buy a share of stock at a pre-specified price. Both in the US and in the UK, exercise prices are typically fixed at the grant-date share price. In the US, options are generally granted after ten years and independent of performance. However, in Europe and especially in the UK, including performance criteria with the stock option is standard practice (Jensen and Murphy, 2004).

Generally, the number of granted options highly increased in the 1980s and 1990s. Pope and Young (2004) state that by 1986 nearly 100% of firms were offering options to their CEOs. Jensen and Murphy (2004) claim that there has been an explosion in grants of share options over the past three decades. However, especially in Europe, the distribution of share options to executive managers has decreased over the last decade. Some reasons for this include such a recommendation in the Greenbury Report and the existence of shareholder groups,

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<sup>10</sup> Earnings per Share (EPS) are earnings returned on the initial investment amount; it is defined by profit divided by weighted average common shares.

<sup>11</sup> Total Shareholder Return (TSR) is commonly used in order to compare stocks and shares of different companies; it is defined by subtracting the share price at the beginning of a period from the one from the end of that period and adding the dividends paid and finally dividing all terms by the share price at the beginning of that period.

like the National Association of Pension Funds and the Association of British Insurers (Pope and Young 2004).

#### **3.1.4. Other incentives**

Other incentives to compensate executives include restricted shares as well as retirement plans and perquisites. Restricted shares are dependent on some conditions that have to be met to make the share fully transferable. When relating restricted shares or stocks to performance, usually a certain time has to pass by to be able to vest the share. Additionally, some targets (those may be financial or operational) may have to be achieved first to vest the shares. During the last years, restricted stocks have become quite popular as a form of compensation for executives, especially as stock options have been subject to corporate scandals in the 21<sup>st</sup> century.<sup>12</sup> Restricted stocks are also a quite common form of remuneration to ensure that 'good' managers will stay within the company, as those shares are binding for a certain time of period. According to Pope and Young (2004), particularly knowledge-based and high-technology industries make use of the availability of restricted stock compensation, as companies within these sectors try to retain knowledge, in the form of human capital, and not pass it on to other companies. Whilst restricted shares are more commonly known in the US, retirement plans are given to executives, especially in Europe.

### **3.2. Trends in CEO compensation**

In the US, The average compensation for chief executives of firms in the S&P 500 Index increased to \$12.94 million last year (American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), 2012). In the subsequent chapters, the development of CEO remuneration as well as the CEO-to-worker compensation ratio, the so-called "CEO pay ratio", is analyzed. While the absolute numbers of executive pay are often debated and criticized, in recent times the ratio between chief executives and other employees has been of interest. In the US, it is likely that the

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<sup>12</sup> There has been an excess of issue of stock options, especially in the US within the large S&P 500 firms (e.g. the Enron Scandal in 2001).

Securities and Exchange Commission (SEC) will adopt rules requiring companies to disclose CEO-to-worker compensation (PricewaterhouseCoopers, 2010).

At present, the level of remuneration in European countries is below that in the US. However, the gap has become smaller in recent years, as executive compensation in Europe has increased rapidly since the beginning of the 21<sup>st</sup> century. In addition, the difference between European compensation and pay levels in the US lies in the variable element of executive remuneration, which is typically larger in the US (Oxelheim et al., 2010).

Today, cash compensation makes up typically less than half of the total amount of executive remuneration, not more than 40 percent. This refers mainly to salary and granted bonuses. The same percentage can be found for equity compensation, i.e. restricted shares and options. Other compensation features such as pensions represent a much smaller fraction of CEO pay (Balsam and Yin, 2012).

### **3.2.1. Absolute CEO remuneration figures**

Since the 1990s, executive pay has grown steadily and beyond the rise that could be explained by changes in performance or company size.<sup>13</sup> If the ratio of compensation to performance or company size stayed at the same level in 2003 as it was in 1993, remuneration levels of chief executives would have been halved. The last years have been marked with a huge increase in equity-based compensation, even though there has not been a reduction in non-equity remuneration (Bebchuk and Grinstein, 2005).

The average level of top executives' compensation in the US rose by 13.9% in 2011, following an even higher percentage of 22.8% in 2010 (in the S&P 500 Index). The S&P 500 Index, however, did not increase last year, suggesting that top executives are the main beneficiaries (American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), 2012).<sup>14</sup>

In 2010, the first year of economic recovery from the global financial crisis, the richest 1% made up 93% of the overall growth in income in the US. The top 1% saw their incomes rise by 11.6%, in contrast to the bottom 99%, who grew only by 0.2%.

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<sup>13</sup> The development of the CEO and top-five executives' compensation figures can be found in the Appendix – Figure II.

<sup>14</sup> See Appendix – Figure III for the composition of an average CEO compensation in 2011 (in the US).

As a consequence, public demonstrations against inequality appeared. National Accounts statistics analyze that firms' profits and issued dividends denote a strong growth in 2011, whereas salary and wage figures remain at a modest level (Saez, 2012).

### **3.2.2. CEO-to-worker compensation ratio**

Executive compensation increased steadily over the last two decades. Even when the global financial crisis started to affect companies' practices worldwide, CEO pay continued to rise (Liu, 2012). In 2005, an average US top executive's salary was higher for one day than an average worker's salary in one year. The past handful of decades have been prosperous times for American CEOs, especially when comparing them to wages of workers (Economic Policy Institute, 2011).

In 1965, the CEO-to-worker-pay-ratio was 24, rising to 35 in 1978 and 71 in 1989. In 2000, the CEO's salary to worker pay ration reached a peak level of 300 (The State of Working America, Economic Policy Institute). Afterwards, the decline of the stock market caused a decline in stock-relative compensation and a moderation of the CEO-to-worker-pay-ratio (it fell down to a level of 131). However, top executive compensation rose again to reach a ratio of 277, until the global financial crisis caused a decline once again (Economic Policy Institute, 2006).<sup>15</sup>

### **3.2.3. Remuneration differences between US, UK and Australia**

Policymakers around the world are trying to find an appropriate answer to the issue of executive compensation in the light of the financial crisis. There are many factors that influence the design process of remuneration plans: company-specific features as well as cultural differences and societal attitude towards executive compensation across the world. Typically, public outrage over excessive remuneration and the rise in CEO-to-average-worker pay ratio is found within companies in the US. Although the disparity in growth of that ratio is less pronounced in Australia, there has still been an increase of executive compensation packages. One reason for the escalation is the fact that Australian firms compete even more with companies worldwide in recent years. Therefore, the level of executive compensation has been adjusted too. In the UK, executive pay has quadrupled in

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<sup>15</sup> The development of the CEO-to-average-worker remuneration ratio of 1965-2009 is illustrated in Appendix – Figure IV.

just one decade. Traditionally, US executive compensation has been much higher than its counterpart in the UK. However, in recent years the gap between the remuneration levels in these two countries is decreased (Hill, 2011).

### **3.3. Performance-based compensation**

Throughout the 1980s, the so-called “leverage buy-outs” (LBOs) became common for many publicly traded firms. Corporate raiders claimed that the weak link between chief executives compensation and company performance was one the main reasons that companies were not maximizing economic value for shareholders. They accused the conventional boards of these firms for being ineffective in compensating their managers. After privatizing these companies, the LBO fund managers took some effective measures motivating CEOs to focus on the maximum economic value of their companies. By noticing the success of these LBOs, investors demanded changes to executive compensation. They insisted on pay packages which would motivate managers to focus on maximising shareholder value. These circumstances led to a huge increase of option-based compensation plans, put in place by corporate boards. By 1994, those stock options constituted the main component of executive remuneration (Institute for Governance of Private and Public Organizations, 2010).<sup>16</sup>

Evidence in the related literature shows that performance-based remuneration packages are granted to attract and retain the best executives in a competitive labor market. Generally, performance-based pay plans tend to be used at smaller companies and new economy firms (Oyer and Schaefer, 2004).

#### *Benefits from performance-based compensation*

Stock options are issued to executives for several reasons. In what follows, I analyze three potential benefits of the issuing of stock options: incentive alignment between managers and shareholders, inducing executives to sort and managers' retention (Oyer and Schaefer, 2004).

- Incentive alignment between managers and shareholders

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<sup>16</sup> See Appendix – Figure V for the rise of stock options in CEO remuneration.



By linking an executive's compensation to the value of the company, some agency problems might be solved. Thereby the manager is motivated to carry out those actions, which are in the best interest of the company's shareholders (Oyer and Schaefer, 2004). The associated literature suggests that companies' stock prices react positively to the implementation of performance-based remuneration packages for executives. It should create a link between the interests of shareholders and management. However, it is not clear whether the company's positive stock price performance at the time of the bonus plan adoption is due to the incentive plan or due to other events surrounding the adoption (Tehrani and Waagele, 1984). An alternative view is that higher stock prices lead to the creation of incentive plans. The possible adoption of a bonus plans correlates with the expected future growth of stock prices if managers have inside information about the company's future performance and thereby hope to benefit from remuneration plans aligning pay and performance (Pfeiffer and Shields, 2012, Warner, 1985).

- Sorting effects of executives

Performance-based remuneration may not always be granted for incentive reasons and therefore may not act as a motivational tool. In fact, it can be used to effectively screen executives within a company (Lazear, 2004). Therefore, in addition to providing incentives to managers, stock options are granted for reasons of sorting (Oyer and Schaefer, 2012). This means that "...the expectation of higher stock prices lead the firm to hire and retain managers who prefer performance based compensation" (Pfeiffer and Shields, 2012).

- Manager's retention

Stock-based compensation is one tool for retaining executives. It is costly for a manager to leave the company if he is granted with any form of performance-based compensation. Companies are more likely to grant options if their returns are more aligned with other companies within the industry that could possibly hire their executives (Oyer and Schaefer, 2004). Moreover, firms adopt stock-based remuneration when facing problems of internal finance. In times of capital requirements or financing limitations, stock-option plans are granted (Core and Guay, 2001).

### *Drawbacks of performance-based compensation*

One drawback of performance-based compensation is the associated requirement for managers to bear risk. Firms and governmental regulators tend to focus on this. Moreover, performance-based compensation packages are typically measured only over the short term. Therefore, the G20 (Group of Twenty) reacted in 2009 by requiring companies within the banking industry to impose bonus schemes that measure the performance over the medium term, i.e. for at least three years. The necessity to evaluate how performance is built and the further need to create bonus plans that incorporate this measure is crucial not only for the banking sector, but for all industry sectors. In addition, international banks are currently in favor of designing new compensation plans for more effective, time-consistent monitoring, as existing stock options and bonus plans are typically measured at a specific moment for the construction of a given performance indicator (Bernard and Courtois, 2012). Nevertheless, the related literature proves that using a multi-period measurement period for a company's performance does not ultimately solve the crucial problem of excessive bonuses. In Germany, a country with sharp regulations on executive compensation, new law on executive pay rewards only sustainable management efforts. Companies are required to measure their performance with multi-year periods. However, by adopting this new measurement, financial literature claims that only yearly ups and downs are balanced. In this connection, the core issue of excessive pay is not addressed (Stern, 2010).

In fact, two phenomena are blamed for spiraling managerial bonuses, which have become the norm over the years: fixed targets for bonus packages and wage benchmarking. The problem with fixed targets becomes visible in times of strong company performance: executives, normally having outperformed the target in good times, are paid large salaries. Furthermore, these high salaries are then measured and recommended for a benchmarking figure for future periods. One compensation design that overcomes these problems is indexing the company's performance. By comparing the firm's performance with that of a peer group, a more sustainable measurement method is found that does not drive bonus inflation (Stern, 2010). This is the background for how RPE contracts emerged. The next subchapter analyzes the use of such pay packages in theory and practice.

### **3.4. Relative performance evaluation**

Rewarding employees efficiently has always been a core subject in financial papers. Basing a worker's remuneration on individual performance provides an incentive for him or her to be productive. However, the measured performance is often influenced by various factors, which are beyond the worker's control. In fact, these random uncertainties have an effect on the performance of other workers, who participate in the same company, industry or market, too. Therefore, RPE may have a large impact on providing incentives to workers, while protecting them from common uncertainties (Gibbons and Murphy, 1990).

It is important to discuss whether risk-sharing advantages exceed the disadvantages. For example, when using RPE for evaluating top-level executives, RPE possesses several advantages. First of all, management's remuneration contracts based solely on firm performance are dependent on the ups and downs of product and stock markets, which cannot be influenced by executive control. The positive effect of RPE is to insulate managers from these market shocks. Additionally, contracts based on RPE are often cheap to administer for top-level management, as the stock performance of other companies in the market is typically accessible at inexpensive costs. Furthermore, it is unlikely that top-management have interactions with executives from other companies. Sabotage and collusive shirking may increase costs to avoid this sort of behavior (Holmström 1982, Gibbons and Murphy 1990).

A simple model of output and wages can highlight the greatest advantages of relative performance evaluation – reducing the risk exposure of risk-averse managers or workers. In the incentive model, output depends on worker's effort, which is unobservable to the employer. Under full efficiency, an insurance against any compensation risk for the worker as well as the supply of an efficient amount of effort must be given. However, the best possible contract for a worker induces him to supply less than the efficient level of effort and therefore it may be meaningful having pay conditioned on a second variable (Holmström 1982, Gibbons and Murphy

1990)<sup>17</sup>. In alternative models, like the learning model, output depends on a worker's ability, which is not always directly observable. In both models, the wage offered to the worker is positively related to his own output but negatively related to the average output of other workers. Both models find a way to filter out common shocks from a worker's remuneration contract and therefore reduce the risk exposure of risk-averse workers in particular (Holmström 1982, Gibbons and Murphy 1990).

Generally speaking, relative performance evaluation filters out a common uncertainty by putting a positive weight on the company's performance and placing a negative weight on the performance of the peer group. Therefore, chief executives receive greater remuneration if shareholders of other companies in the same market have lower returns (Aggarwal and Samwick, 1999b).

In 2006, the Securities and Exchange Commission (SEC) released a new regulation on enhanced disclosures of using relative performance evaluation in compensation contracts. The measurement applied to evaluate executive performance is regulated, as well as the extent of reliance on relative performance evaluation (De Angelis and Grinstein, 2011).

### *Benefits of Relative Performance Evaluation*

The advantages for using RPE for CEOs and top-level management include the process of filtering out industry and market shocks from the manager's compensation, easy measurement of the stock-market performance of other companies in the peer group and the minor potential for sabotage or other interactions with managers in competitive companies. Therefore, risk-averse executives are better off with the inclusion of RPE within their executive compensation contracts.

Another possibility of filtering out common risks or shocks in the same market is to tie manager's remuneration decisions on the basis of his performance to the performance of another executive in the same company.

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<sup>17</sup> Gibbons and Murphy (1990) declare that the second variable has the function to provide better incentives without increasing the compensation risk or provide more insurance against the risk without reducing the incentives.

However, the costs of RPE might be large in this situation, as the possibility of sabotage or collusion is quite high and RPE might interfere with the interest of shareholders to maximize team production (Lazear and Rosen, 1981, Gibbons and Murphy, 1990).

#### *Drawbacks of Relative Performance Evaluation*

Despite the above-mentioned benefits, there are also disadvantages of rewarding managers according to relative performance evaluation, like the cost of measuring the average output in the market. Moreover, the size of the reference group may entail costs, if the cost of measuring an additional worker's output exceeds the gain from including it in the average output. Besides these simple measurement costs, RPE can induce the worker to take actions that affect the average output of the peer group:

- (i) Sabotage: if a worker undertakes some actions to reduce the performance of a manager in the reference group.
- (ii) Collusion: a situation where workers within the same peer group work together.
- (iii) Choice of reference group: if a worker is involved in the evaluation process of choosing a specific reference group.
- (iv) Production externalities: a situation where actions of one worker may have an effect on the output of another manager within the same peer group, as in the case of team production.

Generally speaking, if the number of workers or the reference group is quite small, costs due to collusion or sabotage may be higher and therefore RPE is more effective in the presence of a large peer group. Moreover, the administration of RPE for chief executives is inexpensive, as stock performances of companies in a firm's peer group are steadily available at virtually no costs (Gibbons and Murphy, 1990).

Holmström's (1982) theory of RPE includes the following propositions: (1) a manager's contract is determined by correlated performance measures of other companies; (2) the average of performance measures of other companies is sufficient for the manager's contract; (3) the common uncertainty (industry risk) is filtered out of the manager's contract. Although theoretical articles in the financial

literature often provide strong support for the use of RPE in CEO compensation (Holmström, 1979, Holmström, 1982, Mirrless, 1976), empirical results show mixed results.

The following subchapter groups papers of different arguments and tries to answer the question of why empirical studies do not often produce common findings.

### ***3.4.1. Related literature on relative performance evaluation***

The first tests on the use of RPE were conducted by Antle and Smith (1986), who analyzed a set of companies for the years running from the 1940s to the 1970s. The authors find mixed results, if the common uncertainty is completely filtered out of a manager's compensation. By contrast, Gibbons and Murphy (1990) analyzed over 1,000 firms in the 1970s and 1980s and find strong support for the use of relative performance evaluation in executive remuneration contracts. They argue that the cost of measurement is quite small and the potential benefits of filtering out the industry risks outweigh the costs. In turn, Aggarwal and Samwick (1999a) find little support for the use of RPE for large firms in the 1990s.

In the first decade of the 21<sup>st</sup> century, 90% of S&P 500 companies granted performance-based pay plans to their executives. Out of these contracts, 34% award their managers with evaluating their performance relative to a peer group (De Angelis and Grinstein, 2011).

#### ***Companies using RPE***

The efficiency of a manager's compensation contract can be improved by taking into account the performance of other firms in the industry, which are exposed to similar business risk. Efficiency increases as information about the common risk factor, which is disclosed by the other firms' performance, allows the common business risk to be filtered out of the manager's evaluation (Antle and Smith, 1986).

Companies use the possibility of relative performance evaluation in CEO pay more, if they face less uncertainty choosing the right peer group. This can be found in industries with similar firm strategies or CEO skills (if executive talents are firm-specific). For example, in high-growth industries or in smaller companies the use of RPE is not prevalent (De Angelis and Grinstein, 2011).

In general, companies use data from benchmark groups mainly for the following three reasons: (1) basing the awards of a firm's performance relative to that of a peer group, (2) using the salary of a peer group to benchmark the CEO's compensation and (3) basing the non-salary components of executive remuneration on that of a peer group (Bannister and Newman, 2003).

Less than half of the firms using RPE benchmark their performance against industry or market-wide indexes. The rest, 61% of the companies, use a self-designed index for benchmarking. Typically, RPE is measured over a period of three years. RPE is used across all industries, but is more frequently utilized in the energy and utility sectors (De Angelis and Grinstein, 2011).<sup>18</sup> Other evidence shows that RPE is utilized in industries such as petroleum refining and paper. Within an industry characterized by greater monitoring and stakeholder concern about the relationship between pay and performance, more companies will apply RPE based compensation systems (Bannister and Newman 2003).

As with many studies, there are some difficulties when comparing different studies of relative performance evaluation. One problem lies within the disclosure of RPE: some companies do not reveal how CEO pay is tied to firm performance (De Angelis and Grinstein, 2011).

### *Companies not using RPE*

Even if executives are protected from several industry risks and market shocks, some issues still remain. The gains and losses related to stock options are associated only with the company's absolute stock-market performance. Therefore, some components still have to be considered in addition to RPE when measuring executive compensation (Gibbons and Murphy, 1990).

This topic is taken up by Aggarwal and Samwick (1999b), who provide evidence that RPE can motivate managers to take actions, which minimize competitors' returns. Especially if companies are strategic competitors within the same industry, remuneration contracts including RPE may change a managers' optimal set of choices. Therefore they observe that the use of relative performance evaluation is lower, the higher the level of competition in an industry.

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<sup>18</sup> Data is taken from De Angelis and Grinstein (2011). The sample consists of 494 S&P 500 firms for the year 2007. See Appendix – Figures VI, VII and VIII for detailed graphics of the above-mentioned results.

Garvey and Milbourn (2003) stress that executives are able to adjust their investment portfolios, i.e. hedge on their own accounts, and thus remove any exposure to market risks by themselves. In this case, executives do not need the company to filter out any risks outside their control. Firms should only apply RPE when the company can provide less costly insurance against fluctuations (De Angelis and Grinstein, 2011).

In contrast to Holmström (1982) who assumes that RPE is costless to the company, Garvey and Milbourn (2003) take two situations into account: (a) executive hedging may be costly to the manager himself due to wealth constraints and (b) RPE may be costly to the firm due to information-gathering, identification of the relevant index and the cause of unwanted executive turnover. Therefore, implications of the model include the fact that companies are providing less relative performance evaluation to a manager if the costs of hedging for executives decrease.

Janakiraman et al. (1992) find that common uncertainty, which should be filtered out of executive compensation contracting according to the theory of RPE, does not represent any irritation or disturbance. Therefore, companies do not find it useful or simply find it too expensive to filter the peer-group component in estimating the performance of CEOs.

Bertrand and Mullainathan (2001) identify that executive compensation responds significantly to luck. By filtering this form of luck, the design of RPE may not be optimal from an agency point of view. Gibbons and Murphy (1990) acknowledge that RPE can have an adverse effect on management incentives: it can distort them if executives have the possibility to take actions that influence the average output of the peer group.

With these drawbacks of equity-based compensation and especially RPE in executive pay contracts in mind, one might question if this form of overcoming an agency problem is the right one. Incentive remuneration certainly entails benefits and encourages the manager to take actions that are in alignment with the interests of shareholders. However, the above-mentioned disadvantages show that one has to be careful when designing compensation contracts for executives.



## **4. PROPOSED SHAREHOLDER VOTING RIGHTS ON EXECUTIVE REMUNERATION**

### **4.1. The financial crisis and government bailouts**

Starting in September 2007, the global economic crisis affected financial markets on a level not seen since the Great Depression in the 1930s. As a direct result, several major financial institutions collapsed. For the general public, remuneration policies of financial companies are partly blamed for the economic crisis. The failure of risk management systems at investment banks and other financial services firms in the US are mentioned as primary causes of the crisis. Incentive remuneration structures encouraged CEOs to focus on risky short-term profits (Cluchey, 2011, Chang, 2011). Evidence shows that pay is indeed quite high in the banking sector, however the pay-performance sensitivity of financial firms is not significantly higher than in any other industry prior to the crisis (Gregg et al., 2011).

As a result of the crisis, liquidity problems and credit failures have become apparent (Cluchey, 2011). A number of companies needed help from the government: bailouts and acquisition of ownership interests have been put on the agenda of the government (Chang, 2011). These bailouts are carried out to prevent an even larger financial breakdown (Müller, 2011). At the end of 2008, the financial stress index reached a level five times higher than in the years before (Federal Reserve Bank of St. Louis, Federal Reserve Economic Data, 2012).<sup>19</sup>

Until recently, CEO compensation has been designed and controlled mainly by the board of directors or a dedicated remuneration committee. Over the past two decades, there has been an ongoing debate regarding excessive CEO compensation and poor alignment of pay to performance (Göx et al., 2011). The recent financial crisis has focused attention on highly remunerated managers in the financial services industry (Squam Lake Working Group, 2010). Through negative media coverage during the financial crisis, shareholders of large public companies have gained more awareness about compensation packages. The public is concerned about excessive payments to executives and the design of compensation packages failing to motivate managers to perform better (Alissa, 2009). Investors, in turn, have pushed

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<sup>19</sup> See Appendix – Figure IX for the development of the financial stress index from 2000 to 2011.

governments for legislation changes to gain more control over remuneration policies. In recent years, policy reforms are raising the role of shareholder voice in corporate governance throughout the world (Ferri and Maber, 2012).

#### **4.2. The demand for more regulation of executive remuneration**

Historically, there has always been a strong link between financial crisis and increased regulation on executive pay. After then Enron scandal in 2001<sup>20</sup>, investors in the US waited for changes of legislation for executive compensation. However, the issue of manager's pay plans has been addressed only in some provisions in the following Sarbanes-Oxley Act of 2002 (Hill, 2011).

As suggested by agency theory, the design of CEO compensation contracts should be aligned with the interest of shareholders, maximizing company profits. Taking this into account, executive compensation contracts often include incentive components that link pay more closely to performance. However, these contracts may be imperfect, as they do not cover all possible states of the world.

There is an ongoing discussion whether inappropriate remuneration policies in financial firms should have contributed to the global financial crisis. Some people argue that the level of pay was too high; others blame the compensation structure. As a result of the global economic crisis, governments around the world are proposing laws to regulate the remuneration of financial executives (Squam Lake Working Group, 2010). The aim of those proposals is to better align remuneration practices with shareholders' interests and promoting the stability of companies and the financial system. According to Timothy Geithner, US Secretary of the Treasury, five principles lead to achieve those goals, e.g. remuneration plans should properly measure the company's performance and transparency is encouraged in the process of designing executive pay contracts (Core and Guay, 2010).

In 2009, the Troubled Asset Relief Program (TARP) established standards for regulating remuneration practices at companies receiving governmental financial assistance. Amongst others, these rules include the following: salary payments

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<sup>20</sup> On December 2001, the energy, commodities and services company Enron filed for bankruptcy. Accounting practices of publicly traded companies in the US have been questioned and regulations on executive pay provisions followed (Hill, 2011).

above \$500,000 are promoted to be in the form of vested stock with sales restrictions; bonuses are limited to one third of the total executive pay; disclosure on perquisites must be increased; tax gross-ups are prohibited on all kinds of remuneration; a compensation committee that is composed of independent directors; a non-binding say-on-pay vote at the shareholder annual meeting (Core and Guay, 2010). The Shareholder Bill of Rights added with some provisions regarding the elimination of staggered boards, the presence of a risk team and independence of the CEO from the board of directors (Hill, 2011).

From 2009 onwards, federal proposals are not only related to executive compensation, but also to shareholder empowerment (Hill, 2011). Of all the proposed issues trying to control executive pay, the model of say-on-pay has been debated in financial literature and public media since its adoption. Therefore I will focus on shareholder voting with its consequences and merits hereafter.

Proponents of shareholder voting rights argue that say-on-pay is a value-enhancing voting mechanism, representing an annual review and confidence vote on a company's pay structure (Carter and Zamora, 2009). Moreover, the proposed shareholder voting legislation aims at shifting the duty of directors, designing executive remuneration contracts, to shareholders (Müller, 2011). By giving shareholders a say on executive pay, they get a right to countervail excessive compensation and risk-taking actions (Hill, 2011). These voting results should ultimately lead to changes in executives' future remuneration.

Many proposals have been hotly debated and have resulted in changes to government legislation (Alissa, 2009). The UK was the first nation to implement a mandatory, non-binding shareholder vote on CEO pay in 2002. This has been followed by the Netherlands, who required companies to cast a binding vote on remuneration since 2003. Two years later, the Swedish government forced companies to have an annual binding shareholder vote on compensation reports of their executive (Göx, 2012).

In sum, 19 out of 27 European nations have established recommendations or legal provisions demanding companies to let shareholders have a right to vote on remuneration. The majority of the countries adopting shareholder votes also require a

binding shareholder vote (13 out of 19 nations).<sup>21</sup> Voting patterns differ across countries and so do their contents. They not only concentrate on annual compensation reports, but also on the remuneration policy of future pay arrangements and actual payments to managers (Göx, 2012). As of 2011, government resolutions on shareholder voting have received greater interest in the US (Ferri and Maber, 2012).

In general, say-on-pay rules are quite similar for companies in the UK and in the US. However, institutional differences can have a varying impact on voting patterns and changes in compensation structures across firms. “There is a greater coordination of institutional shareholders in the UK, as members of Association of British Insurers and the National Association of Pension Funds who together own about one-third of listed shares, appear to act in consultation” (Balsam and Yin, 2012). In contrast, companies (especially institutional investors) in the US often depend on proxy advisory firms.

The subsequent chapters analyze possible designs of shareholder voting rights. Additionally, a background of proposed regulations is presented, focusing on shareholder rights in the UK and US. Recently proposed legislation on binding shareholder voting in Switzerland has attempted to reduce excessive executive compensation, as a result of adverse media publicity.

### **4.3. Overview of shareholder voting rights**

Shareholder votes on executive pay, i.e. say-on-pay, should facilitate the communication between the board of directors and a company’s CEO on various elements of pay packages. By giving shareholders a right to vote on compensation issues, the board’s remuneration policy becomes independent from boards’ and managers’ interest (Göx, 2012).

When looking at a company composed of shareholders, board of directors and a CEO, an extended version of the standard agency problem may arise, as shareholders delegate the design of a CEO’s pay package to the board of directors.

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<sup>21</sup> See European Commission (2010) “Report on the application by Member States of the EU of the Commission 2009/385/EC Recommendation (2009 Recommendation on directors’ remuneration) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies”, [http://ec.europa.eu/internal\\_market/company/directors-remun/index\\_en.htm](http://ec.europa.eu/internal_market/company/directors-remun/index_en.htm) (accessed on July, 14<sup>th</sup>, 2012).

This can be problematic as the nomination of board members can be influenced by the CEO. Therefore, a key variable is the level of board dependence. A more dependent board, consisting of insiders or executives from other firms in the industry, can offer more generous remuneration contracts to executives on the one hand, but increases firm value by giving more company-specific advice to executives on the other hand (Göx, 2012).

Shareholders can influence the level of board dependence by approving or disapproving the CEO's board nomination. Furthermore, they can influence the level by threatening to refuse the board's remuneration policy. If say-on-pay is binding, they can force the board of directors to downsize the compensation package; if it is advisory, they can cast a negative vote on the proposed CEO's compensation and in this way influence the board.

On the other side, shareholders would accept a more dependent board if it contributes to a higher firm value (by advising the CEO). Moreover, a lower generosity towards the compensation of the CEO increases the willingness of shareholders to approve a higher level of board dependence.

In general, there is no single policy for enforcing the one and only say-on-pay vote, i.e. one approach of votes that is uniformly adopted by all nations. Some countries require a vote on the compensation of CEOs, other cast their vote on directors' remuneration (typically containing CEO pay). In addition, shareholders are sometimes asked to approve the compensation structure, while others are asked to vote on the compensation policy. The former centers on specific compensation elements that are granted to executives or directors, whereas the latter includes remuneration objectives and approaches (Larcker et al., 2012). Moreover, depending on the country's legislation or the corporation's policy, shareholder voting rights can differ by their enforcement nature. One can distinguish between advisory and binding voting rights.<sup>22</sup>

#### **4.3.1. No voting rights (voluntary votes)**

Although there have been many adoptions of mandated say-on-pay rules in various governments throughout the world in the last decade (starting with the UK in

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<sup>22</sup> See Appendix – Figure X for a detailed overview of different models on say-on-pay in various countries.

2002), some countries still have no uniform rules on shareholder voting rights. One country of special interest regarding this issue is Canada. Until now, there has been no resolution mandated by the government that firms are required to let their shareholders have a voice on compensation issues in Canada. However, in February 2009, three major banks in Canada adopted voluntarily say-on-pay rules in their annual general meeting: the Royal Bank of Canada, the Canadian Imperial bank of Commerce and the National Bank of Canada. These three companies have been the first banks in Canada to give their shareholders a voice on executive compensation (Trottier, 2011). Today, there already exists a long list of companies having voluntarily adopted say-on-pay proposals in their annual meeting in Canada (Shareholder Association for Research and Education, 2012b).<sup>23</sup>

When comparing the effects of both advisory say-on-pay and giving shareholders voluntarily a right to vote on executive compensation, there are some interesting findings. By permitting say-on-pay votes in annual meetings, directors and executives are showing their trust in shareholders. Additionally, say-on-pay votes ultimately lead to more investments by shareholders. However, the level of trust and the willingness to invest resources are even greater if the voice on remuneration is given voluntarily to shareholders than enacted by law (Bowlin et al., 2012).

The American computing corporation Microsoft has granted their shareholders a voluntary vote on executive remuneration every three years, starting in 2009, before the Dodd-Frank Act was released (Bowlin et al., 2012). The company declared that shareholders' votes are important for transparent policies enhancing investor trust in companies like Microsoft. They believe that a three-year cycle of say-on-pay votes gives shareholders enough time to analyze short-term and long-term remuneration packages granted to executives and helps directors to respond thoroughly on the shareholders' advises.<sup>24</sup>

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<sup>23</sup> "It is intended to form an important part of the dialogue between companies and their shareholders about performance targets and salaries for corporate executives. ...SHARE advocates for the adoption of a say-on-pay by all Canadian companies" (Shareholder Association for Research and Education, 2012a).

<sup>24</sup> See Microsoft Corporation, "Microsoft's Board Adopts New "Say-on-Pay" Policy" (B. Smith and J. Seethoff, September 17, 2009), [http://blogs.technet.com/b/microsoft\\_on\\_the\\_issues/archive/2009/09/18/microsoft-s-board-adopts-new-say-on-pay-policy.aspx](http://blogs.technet.com/b/microsoft_on_the_issues/archive/2009/09/18/microsoft-s-board-adopts-new-say-on-pay-policy.aspx) (accessed on July 16<sup>th</sup>, 2012).

#### **4.3.2. Advisory (non-binding) voting rights**

With an advisory say-on-pay voting right, shareholders attain higher firm value by requesting the board of directors to reduce CEO pay. The board will follow their advice, as they experience potential disutility from a negative voting outcome (e.g. negative press, lawsuits). Therefore, they accept a higher level of board dependence, which in return raises the CEO's compensation and his effort level. This scenario however only occurs if shareholders and the board of directors have social preferences. This means that shareholders may have preferences for particular executive compensation schemes, regardless of whether the applied remuneration package changes their personal utility or not (Göx, 2012).

From an economic point of view, giving shareholders no voting rights on executive compensation has the same impact as providing them with an advisory voting right. In both cases, the investors of a company have no right to restrict payment packages to CEOs. Under an advisory voting regulation, the manager chooses the project which is in alignment with the company's goals, but he extracts the highest output he can get (a maximum possible bonus). This type of regulation does not have a significant impact on either executive compensation or firm profit and it is ineffective in preventing excessive CEO pay (Göx et al., 2011).

Advisory say-on-pay is the most common form of governmental regulations of shareholder voting rights on executive performance. The two most prominent countries that adopted this kind of regime are UK in 2002 and US in 2010.

#### **4.3.3. Binding voting rights**

When shareholders' voting rights are binding, a given board of directors has to accept the voting outcome afterwards and reduce pay packages of CEO in the case of voter disapproval. Therefore, shareholders can effectively prevent the CEO's pay package from undesirable remuneration components. Binding shareholder voting rights can be further classified according to the timing and the conditions of the say-on-pay vote. Regarding the timing, there is a common split between pre-contractual votes and post-contractual votes. When taking the conditions of the say-on-pay vote into account, it can be distinguished between unconditionally binding and conditionally binding votes (Göx et al., 2011).

### *Pre-contractual vs. post-contractual voting rights*

A pre-contractual say-on-pay regulation has been established in the Netherlands in 2003 and in Sweden in 2005, submitting the executive pay contract to the shareholder meeting for approval before the compensation agreement is drawn and signed. After the voting outcome, the board of directors decides on potential revisions to the compensation contract (Göx, 2012).

Taking a binding say-on-pay into account, the level of board dependence and the remuneration paid to the CEO is controlled by shareholders. Binding votes can be distinguished between pre-contractual and post-contractual proposals, i.e. if it takes place before or after the CEO's compensation contract is set. A pre-contractual binding say-on-pay voting right influences the CEO to propose a less dependent board of directors, which will in turn set a lower remuneration for the CEO. The shareholders' utility increases, leading to the highest level shareholder value of all versions of say-on-pay (Göx, 2012).

On the other hand, having a say-on-pay vote after setting up the contract for the CEO, shareholders have an incentive to reject all pay elements of the CEO subject to a shareholder approval. A CEO foresees this and cuts his own effort level, leading to a lower level of CEO's compensation and firm value than for all other designs of say-on-pay. When considering post-contractual voting rights, the board of directors designs the remuneration contract of the CEO before the shareholders have their say on executive compensation. During the say-on-pay vote, shareholders can express their dissatisfaction and impose a pay cut. This regime of say-on-pay can be found in the law proposal incorporated in the ongoing initiative proposed by Thomas Minder, in Switzerland (Göx, 2012).

### *Conditionally vs. unconditionally binding voting rights*

Another method of classifying binding votes is to look at potential project outcomes. Under unconditional binding voting rights, shareholders vote on executive compensation independent of the firm's or project's performance. As a result, shareholders are able to take a larger share of realized returns of a risky project and therefore have an incentive to reject a proposal on CEO's executive compensation ex post. However, this discourages an executive and it is likely that he anticipates shareholders' reactions. Therefore, he prefers to choose a riskless project.



Shareholders and managers are captured in a prisoners' dilemma, which is decreasing CEO pay and firm profit. Unconditional shareholder voting rights prevents the selection of the right goals and thus reduces both investment incentives of executives and firm profit (Göx et al., 2011).

Introducing conditional binding voting rights can impede this kind of dilemma, assuring that the expected bonus for the executive remains sufficiently large. Under this kind of regime, shareholders are only able to vote in case of a failure of the firm's or project's performance. In cases of success, shareholders are given no vote at all. Like advisory say-on-pay, this method does not have a large impact on CEO pay and firm profit; however, one can avoid any distortion of executives' investment incentives. The big benefit of conditional binding shareholder votes is the efficiency it entails when reducing excessive remuneration in the case of poor firm performance (Göx et al., 2011).

#### **4.4. Advisory (non-binding) say-on-pay**

There are many countries, which installed advisory say-on-pay as a shareholder mechanism to control executive remuneration at annual meetings. The most interesting countries to analyze are the UK and the US, as they have been hit hard by the financial crisis. Moreover, public outrage about excessive compensation often targets remuneration practices of international companies in these two countries. As the UK was the first country to release a say-on-pay vote, many other countries rely on its experiences with shareholder voting.

##### ***4.4.1. Shareholder rights in the UK***

British legislation has introduced several reports promoting transparency in corporate governance systems since the early 1990s. Based on the Cadbury Report in 1992, the Greenbury Report incorporates a framework of best practices on directors' remuneration in 1995. The Hampel Report in 1998 subsequently encouraged shareholders to take an active part in company decision-making, such as approving new long-term incentive plans for managers.

In 2002 the UK government finally imposed the Directors' Remuneration Report Regulations (henceforth DRR), with the ambition to provide more transparency in

compensation packages to investors (Conyon and Sadler, 2010). Moreover, firms should profit from an improvement in accountability and a more effective linkage to performance, in accordance with the DRR legislation (Alissa, 2009). These regulations require all public companies to disclose their pay packages in annual accounts and give shareholders a mandatory but non-binding vote on executive compensation at the Annual General Meeting (Conyon and Sadler, 2010). The act states “No entitlement of a person to remuneration is made conditional on the resolution being passed by reason only of the provision made by this section” (DRR 2002, Section 241A (8)). The UK is the first country to release a say-on-pay initiative (Balsam and Yin, 2012).

In the UK shareholders are generally satisfied with the remuneration packages of their managers and vote in favor of the DRR. On average, less than ten percent of shareholders vote against a mandatory say-on-pay resolution. Actually, shareholder approval of the DRR is increasing over time. Nevertheless, shareholders are concerned about executive compensation and use the possibility of the say-on-pay vote for expressing their dissatisfaction and negative view of the board's compensation practice (Alissa, 2009).

Companies that can be characterized as having excess CEO pay show an increase in the sensitivity of CEO pay to poor performance (Ferri and Maber, 2012). In the case of the British company GlaxoSmithKline, shareholders voted against the approval of the remuneration report in 2003. Negative publicity in the press has also surrounded the event as the pay package for the CEO Jean-Pierre Garnier has been perceived as too excessive. Shareholders have signaled their disapproval by voting against the package of their CEO. Although the shareholder voting results were non-binding, the pay structure of GlaxoSmithKline's managers changed after the vote (Conyon and Sadler, 2010).

When comparing shareholder voting on CEO pay to voting on non-payment proposals, shareholders are more likely to vote against say-on-pay proposals than non-pay issues, like the routine election of board members or the appointment of auditors. Furthermore, shareholders tend to vote against other pay resolutions, such as short-term or long-term incentive plans and stock options, more than voting

against non-pay resolutions. This suggests that with their negative vote on say-on-pay, shareholders like to signal their dissatisfaction about ongoing payment practices (Conyon and Sadler, 2010).

Companies with higher executive remuneration tend to receive more negative votes in a say-on-pay resolution than firms with average CEO pay (Carter and Zamora, 2009, Conyon and Sadler, 2010). Dissent among shareholders does not necessarily result in a reduction of a manager's future compensation (Conyon and Sadler, 2010, Ferri and Maber, 2012). Nevertheless, they reduce executives' future pay if there is a large amount of shareholder dissent in companies with excessive CEO remuneration (Alissa, 2009). Another possible indicator for future compensation reduction is a high percentage of shareholders' negative votes. Those companies, which have been reluctant in the past to change intensely, debated payments like generous severance contract payments show high dissent in the subsequent say-on-pay voting. If these firms take the shareholders' voting advice to reduce criticized payment schemes into account, they are rewarded with a decrease in negative shareholder votes at the following say-on-pay vote. However, if these firms do not consider the shareholders' voting advice, they are further penalized with an even higher voting dissent at the next say-on-pay vote. Concluding, most companies with high voting dissent tend to reduce future payments to CEOs that are criticized a lot. Companies, who have already reacted in the past to criticized compensation packages, are likely to perform positive at the say-on-pay voting (Ferri and Maber, 2012).

Say-on-pay voting has an effect on another compensation issue, namely the performance based vesting condition in equity grants. These so-called "retesting provisions" make it possible to re-evaluate performance goals in the following years, if they have not been achieved during the first measurement period. These provisions have been criticized as a "reward for failure". After a say-on-pay-vote, companies with high dissent voting tend to cut or completely remove these provisions from managers' compensation packages (Ferri and Maber, 2012).

There is a positive relationship between negative voting outcome in a shareholders' say-on-pay proposal and a weak pay-for-performance link in

managers' bonus payments (Carter and Zamora, 2009). Subsequently, firms with a high dissent voting during a say-on-pay proposal tend to strengthen the pay-for-performance link and thus increase the sensitivity of CEO pay to poor performance. The relationship between managerial compensation and other economic factors remains largely unchanged (Ferri and Maber, 2012).

The announcement of the adoption of the DRR regulation in the UK resulted in a positive stock price reaction, especially for those companies showing controversial pay practices, like granting their managers generous severance contract payments or retesting provisions for option grants (Ferri and Maber, 2012).

Say-on-pay proposals with high dissent votes do not ultimately lead to an increase of equity fraction in a CEO's pay package, which should align interests from owners to those of managers (Conyon and Sadler, 2010). It may even have an opposite effect: shareholders react by negative voting if there is a potential excessive dilution from stock based compensation. Boards respond to this voting dissent by curbing dilution from stock option grants (Carter and Zamora, 2009).

High dissent voting results can even force CEOs out of their office, representing an extreme reduction of excess remuneration. The CEO can be fired by the board or be pushed out of the company, refusing to accept a decrease in his yearly payment package (Alissa, 2009).

#### ***4.4.2. Shareholder rights in the US***

As a response to the global financial crisis starting in 2007, several programs have been started and various acts enabled in the US to satisfy shareholders' demand for a right to vote on executives' remuneration.

The US Securities and Exchange Commission (SEC) introduced a rule in 2006 requiring companies to focus on disclosure with the objective of improving transparency and comparability. The pharmaceutical corporation Pfizer Inc. reacted to this ruling with a voluntary disclosure of the CEO's pension package. In succession, two board members were required to step down after the shareholder

vote, in addition to the CEO stepping down as well.<sup>25</sup> Since then, the first shareholder proposals on executive remuneration in US public firms have been submitted. They have mainly received significant shareholder support, however boards have ignored proposals even with positive voting outcomes at first. Negative response by companies centred on this topic. Home Depot's executives responded "...an advisory vote would not provide the Committee with any meaningful insight into specific shareholder concerns regarding executive compensation that it could address when considering the Company's remuneration policies. Finally, an advisory vote is impractical when more effective means of communicating concerns to the Committee are available to shareholders" (Thomas et al., 2012).

Beginning in 2009, companies receiving federal assistance under the TARP have been mandated to adapt advisory shareholder votes on executive remuneration (Larcker et al., 2012). The Emergency Economic Stabilization Act introduced this requirement as a response to the public outrage that federal bailout funds have been used in the past to remunerate executives bonuses (Thomas et al., 2012). Some companies who did not receive aid under the TARP, have even conducted voluntarily say-on-pay voting proposals (Larcker et al., 2012).

From 2006 onwards, there have been requests for shareholder voting rights on compensation. The number of proposals calling for say-on-pay quickly increased (Institute for Governance of Private and Public Organizations, 2010).<sup>26</sup>

Barney Frank, Chairman of the House Financial Services Committee, and Chris Dodd, Chairman of Senate Banking Committee, proposed the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (hereafter Dodd-Frank Act) in December 2009. In July 2010, President Obama finally signed the Dodd-Frank Act, representing a significant shift in the financial market legal system of the US (Chang, 2011). Effective with January 21, 2011, most publicly traded corporations have to comply according to the long awaited say-on-pay rules, which are embodied in the Dodd-Frank Act. The act requires that companies give their shareholders the opportunity to vote on a non-binding basis on executive remuneration (Balsam and

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<sup>25</sup> See CFO Magazine "Pay dirt: As the SEC shines a light on executive compensation, will companies clean up their acts or find new ways to hide excess?", (D. Durfee, October 1, 2006), <http://www.cfo.com/article.cfm/7987653> (accessed on July 13<sup>th</sup>, 2012).

<sup>26</sup> See Appendix – Figure XI for the development of numbers of requests for say-on-pay votes in the US.

Yin, 2012). Subsequently, shareholders should conduct a vote on the frequency of say-on-pay votes, at a minimum of one every three years (Liu, 2012).

*(i) Proxy advisory companies*

For more than a decade, the adequateness of remuneration levels for executives has been a widely discussed topic. Limitations to executive pay have often been carried out by utilizing taxes (making certain pay packages expensive) or by increasing disclosures (SEC revisions for reporting executive remuneration in annual statements). Shareholder voting on managers' compensation represents a new mechanism to influence pay practices (Larcker et al., 2012).

As stated above, in the US institutional investors hold the majority of the outstanding shares of publicly traded companies. These investors often rely on proxy advisory companies, who provide them with data, policies, guidelines and finally recommendations on shareholder proposals, like say-on-pay (Balsam and Yin, 2012, Larcker et al, 2012). Institutional Shareholder Services (ISS) and Glass Lewis & Co. (GL) are the two dominant players in the market for proxy advisory services (Ertimur et al., 2012).

ISS evaluates five features of executive compensation: pay for performance evaluation, non-performance-based pay components, peer group benchmarking, severance arrangements and finally compensation committee communication and effectiveness. Evaluating them with high, medium or low levels of concern, the following issues can result in a negative recommendation on say-on-pay: misalignment between executive compensation and performance, poor communication and responsiveness to shareholders and problematic pay practices (Larcker et al, 2012). Companies showing high concern ratings in one or more key features do in general receive an "against"-recommendation (Ertimur et al., 2012).

On the contrary, GL uses three categories for their analysis: pay for performance, structure and disclosure. Assigning them with ratings (structure and disclosure) and grades (pay-for-performance), the following key pay elements get the poorest figures: a lack of clawback provisions, limited performance-based incentive plans, tax gross-ups, controversial features in severance plans and lack of ownership requirements. In general, companies with the same grade or rating on one pay feature do not necessarily receive the same recommendation from the proxy advisory firm.

Moreover, firms with high concern rating in one key element do not automatically receive an “against”-recommendation (Ertimur et al., 2012).

There is a steadily growing use of proxy advisory companies by institutional shareholders as assessments of executive pay practices across all companies in their portfolio can be costly and complex. However, an ongoing wave of criticism is taking place in the proxy advisory industry, as the duopoly structure (ISS and GL are the primary players in that sector) may leave advisory companies lacking the incentive to invest in costly research.

If recommendations from advisory companies find poor practices within the company in question, a change of executive compensation may increase shareholder value. However, if recommendations from advisory companies are inappropriate, it is possible that an adaption of executive pay encouraged by say-on-pay votes may not increase shareholder value. Alternatively, negative market reactions to the announcement of a change in pay packages might arise due to the fact that compensation changes signal poor performance in the future (Larcker et al., 2012).

In accordance with the Dodd-Frank Act, companies are required to conduct a non-binding shareholder vote with shareholder meetings on or after January 21<sup>st</sup>, 2011. Interestingly, there has been a radical boost in the moving of shareholder meeting dates to a time before January 21<sup>st</sup> 2011. The concentration of meetings before that crucial day suggests that firms tried to avoid being subject to a say-on-pay vote for that year (Larcker et al., 2012).

As shareholders rely in part or even in whole on the recommendation of proxy advisory firms, it is possible for firms to decrease negative voting outcomes by obtaining a positive recommendation from these advisory firms. Companies can achieve this by changing their pay packages a priori aiming for a closer alignment with the guidelines of advisory companies and sticking to particular compensation features for a more favorable voting outcome (exclusion of tax gross-ups and increase of performance-based pay packages). This is traditionally done before the release of the proxy advisory recommendation. Results from a survey show that over 70% of pay packages have been influenced by guidelines and policies of proxy advisory companies (Larcker et al., 2012).

Key compensation features causing negative recommendation by proxy advisory firms are often changed to get a more positive voting outcome. After the change of their remuneration programs, they subsequently received a positive recommendation (Lublin, 2011). The infrastructure, finance and media company General Electric and the mass media company Walt Disney both changed their remuneration packages after filing their proxy statements to get a more positive shareholder's say-on-pay proposal. General Electric Company imposed stricter conditions and measurements for the stock option grants of CEO Jeff Immelt, while The Walt Disney Company eliminated tax gross-up from compensation agreements of four top executives. ISS adapted their recommendation for both companies on the date the compensation change was announced by the companies (Larcker et al., 2012).<sup>27</sup>

*(ii) Voting pattern and future executive remuneration*

In general, most companies and their CEO's pay packages have received support by the majority of shareholders voting on executive remuneration. However, there are some discrepancies towards the frequency of say-on-pay votes. 60% of the firms recommended conducting a say-on-pay vote only every three years, whereas 90% of shareholders of these companies vote for an annual say-on-pay vote. Companies react to shareholder recommendations, as the current increase of companies' preferences show: the preferred frequency of voting on executive compensation every three years by 60% of all analyzed companies has changed to a preferred vote every year by 63% of these firms (Liu, 2012).<sup>28</sup>

Some US companies made changes to executive compensation before the say-on-pay vote, thereby looking for a subsequent shareholder approval (Balsam and Yin, 2012). Several firms reduced the amount of cash compensation (salary and bonus) for their executives prior to a say-on-pay vote (Liu, 2012). A decrease in

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<sup>27</sup> See also The Wall Street Journal, "Strings attached to Options Grant for GE's Immelt", (A. Dowell, J. S. Lublin, April 20, 2011), <http://online.wsj.com/article/SB10001424052748703789104576272701168635450.html> (accessed on July 18<sup>th</sup>, 2012).

<sup>28</sup> See Appendix – Figure XII for the recommendation by the company and subsequent shareholder vote on the frequency of say-on-pay proposals.



compensation was higher for companies who overpaid their CEO or top executives in the last year(s). Typically, the larger the downward modification, the less likely shareholders cast their vote against CEO pay. There has been a shift of the compensation mix for CEOs. Especially, an increase of performance-based remuneration can be found. This is consistent with larger firms and companies with well-paid executives (Balsam and Yin, 2012).

There are some interesting findings on say-on-pay voting pattern of companies in the US. Firms decreasing their compensation package in advance of the vote get usually a higher voting approval. Vice versa, a high total compensation or a high increase in pay from the previous year tends to be opposed by shareholders. Additionally, shareholders cast their vote against executive compensation if it cannot be explained by economic factors. Moreover, perquisites (such as country club or private jets) in a CEO's pay package often result in negative voting outcomes. The retention of tax gross-ups, an often-criticized feature of CEO compensation, leads shareholders to cast their votes against compensation packages too (Balsam and Yin, 2012).

Surprisingly, some evidence shows that low shareholder support or rejection in a say-on-pay vote does not necessarily have the desired effect of reducing excess remuneration and leading to changes in the composition of future executive compensation (Armstrong et al., 2012).

Interestingly, the pay component 'salary' is associated positively with voting outcomes. An increase in fixed and non-performance based elements of pay packages are generally viewed favorably by shareholders. This can be explained by the fact that the paid salaries do not incorporate incentives to take risks (Balsam and Yin, 2012).

Strong firm performance is mostly rewarded with more votes in favor of the shareholders. The same is true for shareholder power, i.e. concentration of institutional shareholders, which is also seen favorable by them. Too much CEO power is typically associated with more votes against executive compensation (Balsam and Yin, 2012).

*(iii) US banking sector*

One say-on-pay disapproval vote caused quite a stir throughout the media worldwide: the shareholders' rejection of a CEO's compensation package for the first time in the banking sector. This happened at the annual meeting of Citibank, the third-largest bank in the US. Shareholders have rejected the pay package of CEO Vikram Pandit in April this year, which has already been approved by the company's board. They casted their votes against the compensation plan of paying the CEO \$15 millions as remuneration for a year when the company's shares fell by 44%. 55% of all shareholders voted against the bank's payout plan. These 55% include also absentee votes, which are counted as rejections by US law. Since US say-on-pay votes are non-binding, the company can take the shareholders' advice but is not forced to change its practices. However, according to the bank's chairman Richard Parsons, Citigroup will define a more formula-based method for designing the pay package of top executives. In advance of the say-on-pay votes, both proxy advisory firms, ISS and GL have expressed their disapproval of the Vikram Pandit's incentive pay and retention programs, both lacking the necessary incentives to achieve the goal of improving shareholder value as well as the absence of a connection between pay and performance.<sup>29</sup>

The disapproval of shareholder voting at Citigroup can have an impact of future say-on-pay votes at larger and smaller banks in the US. However, one month after Citigroup's shareholder vote, the compensation plans for top executives at the two other large banks in the US, J.P. Morgan Chase & Co. and Bank of America, have been approved in the required say-on-pay vote.<sup>30</sup>

#### **4.5. Binding say-on-pay**

Shareholder voting rights, which are binding to a company's directors and executives, have been put on the agenda of legislation of various countries, e.g.

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<sup>29</sup> See The Guardian, "Citigroup shareholders reject CEO Vikram Pandit's pay package" (D. Rushe, April 17, 2012), <http://www.guardian.co.uk/business/2012/apr/17/citigroup-shareholders-reject-ceo-pay> (accessed on July 14<sup>th</sup>, 2012).

<sup>30</sup> For more information, see also The Wall Street Journal, "Regional Banks Feeling Citi Pay Pain" (R. Sidel, S. Kapner and J. S. Lublin, April 18, 2012), <http://online.wsj.com/article/SB10001424052702304331204577352280113526076.html> (accessed on July 16<sup>th</sup>, 2012).

Netherlands and Sweden. In Switzerland, one initiative aiming for more shareholder rights regarding executive compensation at all publicly trading Swiss companies concerns the whole country. In the subsequent chapter, the background and the successive consequences of this initiative are analyzed.

#### **4.5.1. Shareholder rights in Switzerland**

At present, there is a public debate over managers and directors of companies that pay themselves a lot of compensation (Bebchuk and Grinstein, 2005). Public outrage leads to discussions about CEO remuneration in the media. This again induced regulatory activities such as the upcoming Swiss initiative “against rip-off salaries” – “gegen die Abzockerei” (Müller, 2011).

In Switzerland, the public can enact new laws by carrying out an initiative, which can be started by every Swiss citizen. If this initiative has been signed by at least 100,000 citizens, it must be put on the agenda for a Swiss national vote. In the event of a positive outcome for the initiative in the popular vote, it will turn into an amendment to the Swiss constitution (Wagner and Wenk, 2012).

The Swiss Federal popular initiative “against rip-off salaries” reached the required signatures within 18 months and was submitted to the Federal Chancellery on February 26, 2008. A single man, the Swiss entrepreneur Thomas Minder, launched the law proposal, which contains a clear program aiming for more transparency in pay structures of Swiss firms (Wagner and Wenk, 2012).

The initiative demands that shareholders of all listed companies in Switzerland are required to cast a binding vote on the total remuneration of executive managers and board of directors on an annual basis. This initiative includes a total of 24 requirements, of which the most important are the following: shareholders have the right to vote ex ante on the amount of the pay package, proposed by the firm’s board, whereas executive compensation in excess of the approved pay package has to be put on a voting agenda ex post. The board of directors has to ensure that the shareholders support their proposed pay packages, as in case of a denial they have to organize a new assembly, which would not raise the firm’s reputation. Moreover, termination pays, advance payments and bonuses in the event of company sales are not allowed any more. A vote of the general assembly is also needed if performance-related payments to executives or directors should be modified. The government of Switzerland designed an alternative draft (“Obligationenrecht - Vergütungen bei

börsenkotierten Gesellschaften sowie weitere Änderungen im Aktienrecht“) to the initiative “gegen die Abzockerei”. However, according to the committee of the initiative, only five out of total 24 requirements have been met. 12 requests have been avoided, thus not fulfilled. Five requirements have been ignored at all. Therefore, the national vote should be either on November 25<sup>th</sup>, 2012 or March 3<sup>rd</sup>, 2013.<sup>31</sup>

The committee of the initiative shows that the total remuneration of board of directors and management has risen by 87% from 2002 to 2006 within companies in the Swiss Market Index. This initiative in Swiss should strengthen shareholder power within a company more than other say-on-pay laws in other countries, as the vote on executive and board remuneration is binding to the company (Wagner and Wenk, 2012).

Wagner and Wenk (2012) analyze the stock market reactions to the announcement in February 2008 of the law proposal. The initiative, aiming at enforcing a popular vote, was not predictable and came quite quickly, compared to standard votes, where the date of the vote is usually known in advance. Additionally, the Swiss stock exchange represents one of the largest stock exchanges worldwide in terms of market capitalization. Therefore, information on stock market reactions can be extracted easily and efficiently.

In general, larger firms are less affected by the announcement of the initiative than smaller corporations. The former are better prepared, whereas the latter face higher costs adjusting to the new law. Companies with highly concentrated or highly dispersed ownership are better positioned in case of legislation change (Wagner and Wenk, 2012).

Companies showing a high performance in the past revealed high stock price drops, whereas firms with poor performance reacted more positively. Moreover, companies with CEOs having excess remuneration do not show any big changes in stock prices, whereas firms paying their executive “normal” salary tended to decrease most. Therefore, there are more positive reactions to a potential binding

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<sup>31</sup> Eidgenössische Volksinitiative “gegen die Abzockerei” (2012), <http://www.abzockerei.ch> (accessed on July, 4<sup>th</sup> 2012).

say-on-pay for companies with current poor alignment between shareholders and executives (Wagner and Wenk, 2012).

Additionally, stock price declines can be found in the following three cases: (1) firms using only cash-based compensation programs for remunerating their executives, (2) firms with younger CEOs or CEOs with short-time employment and (3) shareholders with higher uncertainty regarding their annual costs or sales. Unlike equity-based remuneration, cash bonuses would require an ex-post shareholder vote. This can lead to biased ex-ante incentives for CEOs (like for equity-based pay packages). Older Executives or with higher seniority are often more willing to make firm-specific investments; whereas their younger colleagues prefer to exercise their outside options. Moreover, it is more difficult for shareholders with higher uncertainty to better align with executives due to the fact that more eventualities have been allowed for (Wagner and Wenk, 2012).

In general, shareholders acknowledge that say-on-pay has benefits for them, but they know that it entails some costs too. If these costs are higher than the expected benefits, they react more negatively leading to a decrease in stock prices. Moreover, it is not in the best interest of shareholders to extend their power. They are better off giving control to their board of directors and motivating executives to make more firm-specific investments and avoid exercising outside options. This is usually the case within an advisory say-on-pay setting, where shareholders' votes stand solely for a hint to executives. Through a binding say-on-pay, shareholder power is enhanced and can hence solve the agency problem between executives and shareholders. However, as stated above, it highlights the hold-up problem too, i.e. executives may be reluctant exercising firm-specific investments (Wagner and Wenk, 2012).

The question remains if a binding say-on-pay vote is the best approach for companies and its shareholders. An advisory vote has two crucial impacts: (1) shareholders can still give their individual feedback to companies and (2) boards of directors can act flexible in matters regarding executive remuneration (Müller, 2011).

#### **4.6. Potential drawbacks of say-on-pay**

Of all the presented models of say-on-pay, there does not exist a "right model" for regulating executives' and directors' compensation and thus overcoming remuneration problems. Additionally, different models vary according to the efficiency

of treating different pay problems. For example, there might exist a different mechanism for resolving a potential misalignment between pay and performance than for limiting excessive payments to CEOs (Larcker et al., 2012).

Giving shareholders a right to vote on compensation contracts is not always the first-best choice. Intensive pressure from the public can encourage firms or even governments to adopt regulatory provisions without taking account of companies' pay structures and all the consequences the measures entail (Göx et al., 2011). Negative shareholder voting outcomes, i.e. a say-on-pay voting failure, might even impose substantial costs to shareholders. Apart from negative press and public outrage, failing to obtain support for say-on-pay proposals can lead to regulatory revisions or distraction of executives and employees. Additionally, companies and board members can be involved in a derivative lawsuit. In 2011, seven companies in the US were sued shortly after the announcement of a say-on-pay voting failure (Larcker et al, 2012).

Policymakers around the world should be careful when regulating the level of executive remuneration. Limiting executive compensation can bear the risk that highly talented employees might not find the most productive occupation, which will slow the economic growth. Limits on the level of remuneration in the financial services industry involve the risk of losing professionals to companies in unregulated sectors or even to firms in other countries, which do not have that intensity of regulation (Squam Lake Working Group, 2010).

When conducting an annual say-on-pay vote, boards sometimes do not have the time for redesigning compensation plans in an efficient way. The short interval between the yearly votes may limit the impact shareholders are expecting after providing their consultation to the company. Moreover, shareholder votes conducted every two or three years have the advantage of being more in alignment with multi-year compensation features. Therefore, policymakers should be careful when adopting a mandatory annual say-on-pay vote. Additionally, it might be challenging enough for shareholders to gather the necessary information on compensation issues every two or three years.

Generally, the primary purpose of say-on-pay is not to establish a direct shareholder control over executive remuneration plans. It rather permits shareholders to influence a board's perspective and react to compensation decisions. Say-on-pay

may encourage shareholders to micromanage companies, despite having a weak understanding of pay structures and incentive systems for executives. If executives anticipate the potential risk of not receiving the total compensation they are expecting, say-on-pay can minimize their effort. At the worst, shareholders can even refuse well-designed executive compensation packages. There is also some evidence that shareholders sometimes reject compensation proposals whenever they have the right to vote in this manner, independent of the voting right applied. However, in most cases poor performance is the trigger for negative voting outcomes (Göx et al., 2011).

The crucial question is if a shareholder say-on-pay voting right is a valuable corporate governance tool. It might be case if excessive executive compensation is a hotly debated issue within companies. However, boards of directors or compensation committees are installed for designing the compensation contract for executives. Shareholders shift this responsibility to directors, as compensation decisions are often time-consuming and complex (Core and Guay, 2010). They are dependent on various factors, including the competitive situation and the company's strategies, as well as the firm's culture and the aim to have a short- or long-term focus.

For outsiders, like big institutional investors, it is not always easy to determine if a specific remuneration plan was appropriate or not. Boards of directors or compensation committees often have company-specific inside information and should be experts in setting pay levels for their executives (Core and Guay, 2010). When designing an executive's pay contract, one has to bear in mind the environment surrounding the company: are there any outside factors that influence a company's strategy? How does a firm's risk profile influence a manager's compensation plan? Moreover, shareholders' say-on-pay votes are a signal to boards of directors and executives, but it can be difficult to assess whether the voting outcome reflects this year's compensation or whether shareholder object to the design of a bonus promised several years ago. What remains is a variety of interpretations of voting outcomes and the question if this process of shareholder consultation is the most efficient one.

## 5. CONCLUSIONS

In times of public outrage on excessive CEO compensation and market pressure on limiting executive pay, recommendations on managerial remuneration made by public institutes and regulations imposed by governments are seen favorably by investors throughout the world. The global financial crisis has awakened policymakers of all nations to focus even more on limiting executive compensation by adopting new rules and conditions.

The core issue of the known-to-all agency theory is to find strategies to align interests of managers and shareholders. Two approaches are developed for overcoming the so-called agency problem: monitoring or controlling the agent and incentive executive compensation. Generally, shareholders of large companies are too diffuse and uninformed to directly control management efficiently. Moreover, the installation of monitor systems is often costly in terms of time and money. Aware of the above-described problem of controlling, the second approach, managerial incentive compensation, seems to overcome the first approach and directly measures a manager's success by linking the manager's remuneration to a company's performance (Jensen and Meckling, 1976).

Typically, equity-based compensation plans are used for incentive executive remuneration. However, evidence has shown that this popular form of remuneration shows some drawbacks, like the possibility of windfall gains: a natural increase in executive compensation due to the good development of a market or industry, and not due to the manager's efforts. This phenomena and other drawbacks show that usual performance-based executive contracts are not always the best answer to solve agency problems (Müller, 2011).

One compensation design that overcomes these problems is indexing the company's performance. By comparing the firm's performance with that of a peer group, a more sustainable measurement method is found that does not drive bonus inflation (Stern, 2010). The so-called relative performance evaluation method filters out common risks of all companies in the same industry from a manager's compensation contract. Companies use data from benchmark groups mainly for the following three reasons: (1) basing the awards of a firm's performance relative to that



of a peer group, (2) using the salary of a peer group to benchmark the CEO's compensation and (3) basing the non-salary components of executive remuneration on that of a peer group (Bannister and Newman, 2003). However, there are mixed findings in related literature for the use of RPE in managerial incentive contracts. Firms find it too expensive to filter the peer-group component in estimating the performance of CEOs (Janakiraman et al., 1992).

In general, executives' compensation contracts in the US often include performance-based incentives, in the form of stock, options or other performance-based remuneration. The percentage of equity incentives in executive's compensation packages is much higher in the US than in any other country. Therefore, the push toward more performance-based incentives seems quite puzzling considering the fact that more equity ownership implies higher executive compensation. If managers are imposed with equity ownership without giving an increase of their remuneration, they focus on reducing the risk of their equity, like rejecting risky projects, if even if they are increasing shareholder wealth (Core and Guay, 2010).

With the beginning of the financial crisis, regulations are not only focusing on limiting executive pay, but also on empowering shareholders. United Kingdom has started in 2002 with the installation of shareholder say-on-pay voting rights, followed by many other nations, including the United States in 2010. Different models of shareholder voting rights in theory and practice are presented. There does not exist one "right" form of say-on-pay voting rules. Every nation or corporation has to decide on its own which form to apply or whether to apply a voting right at all. Companies in Canada show that voluntary votes are sometimes a better way to show trust in boards of directors and specific compensation committees.

The existing literature differs on the positive outcomes of say-on-pay votes. Say-on-pay legislation increases shareholders' power for reducing CEO excessive pay and shareholders' control of the design of the CEO pay packages. As Conyon and Sadler (2010) discover, say-on-pay rules encourage shareholder activism by giving them more power to alter pay structures of executives and board of directors. Ferri and Maber (2012) reveal that advisory votes help shareholder to overcome possible barriers when negotiating with executives at year-end. Moreover, the relationship

between CEOs and shareholders is strengthened. It is a tool for pushing companies to eliminate controversial pay practices, like excessive payments to CEO despite poor performance of the company.

On the other hand, shareholder voting appears to have limited effects on reducing excess executive compensation (Conyon and Sadler, 2010). In the UK, say-on-pay resolutions are non-binding. After a negative voting outcome, the management can easily disregard the shareholders' vote, unless it is binding for them. This occurs especially for companies with relatively low voting dissent (Carter and Zamora, 2009). Additionally, managers might be encouraged to indirectly misinform shareholders, leading to suboptimal payment plans (Ferri and Maber, 2012). However, evidence from the financial literature points to the high dissent voting in say-on-pay proposals which might affect the company's reputation and therefore push firms to react in accordance with the shareholder voting results (Alissa, 2009, Ferri and Maber, 2012).

Although both the US and the UK have implemented say-on-pay regulations on publicly listed companies, there is ongoing public outrage for even more shareholder rights in these countries. According to the critics, the non-binding voting nature is not strong enough to prevent undesirable pay elements in remuneration contracts (Göx et al., 2011). In the US, there are requests for binding say-on-pay votes and further increase shareholder power. For example, the Excessive Pay Shareholder Approval Act, published in 2009, requires that 60% of all shareholders have to approve the vote on executive compensation, if a manager earns 100 times more than the average employee within a company (Wagner and Wenk, 2012). In the UK, the Prime Minister David Cameron suggested installing a say-on-pay vote that is binding in nature, like in other European countries, e.g. the Netherlands or Sweden. It is up to companies all over the world, whether changes in legislation resulting in modifications in executive contracts and shareholder empowerment will lead to a cultural shift in the future (Hill, 2011).

Nowadays, companies face intense pressure to select the appropriate, most efficient, cost-saving and shareholder-satisfying executive compensation contracts. In addition, the CEO-to-average-worker pay ratio has received more attention in recent years, as it has risen to an exorbitant level. To put it in another way: "We need

to decide as a society whether this increase in income inequality is efficient and acceptable and, if not, what mix of institutional and tax reforms should be developed to counter it" (Saez, 2012).

## **6. ABSTRACTS**

### **6.1. Abstract – English version**

This thesis provides possible solutions to the agency problem, i.e. finding mechanisms for aligning interests of managers and shareholders. In times of the global financial crisis, the rise of executive compensation is debated all over the world. Actual compensation figures are presented as well as the development of CEO-to-average-worker ratio. Two approaches are developed for overcoming the agency problem: monitoring or controlling the agent and incentive executive compensation. As controlling the agent is often costly in terms of time and money, many companies focus on executive performance-based compensation, which links a manager's remuneration to a company's performance. As a very special form of incentive-based compensation, the model of relative performance evaluation is examined.

Recent discussions do not only include regulation of executive compensation, but also how to empower shareholders. Say-on-pay models have mushroomed in many countries. The UK was the first country to release a mandatory shareholder voting at annual meetings of publicly traded companies. In 2010, the US followed the UK example with the adoption of a mandatory but non-binding say-on-pay for all large companies. As a very recent topic, the proposed legislation on binding shareholder voting in Switzerland is analyzed. Despite the enthusiasm among investors, say-on-pay has its critics too. Negative voting outcome might impose substantial costs to shareholders. Efforts of executives can be minimized, if they anticipate a potential risk of not receiving the total compensation they are expecting. There is as higher risk in industries with say-on-pay regulations of loosing professionals to companies in unregulated sectors or even to firms in other countries, which do not have that intensity of regulation.

## **6.2. Abstract – German version**

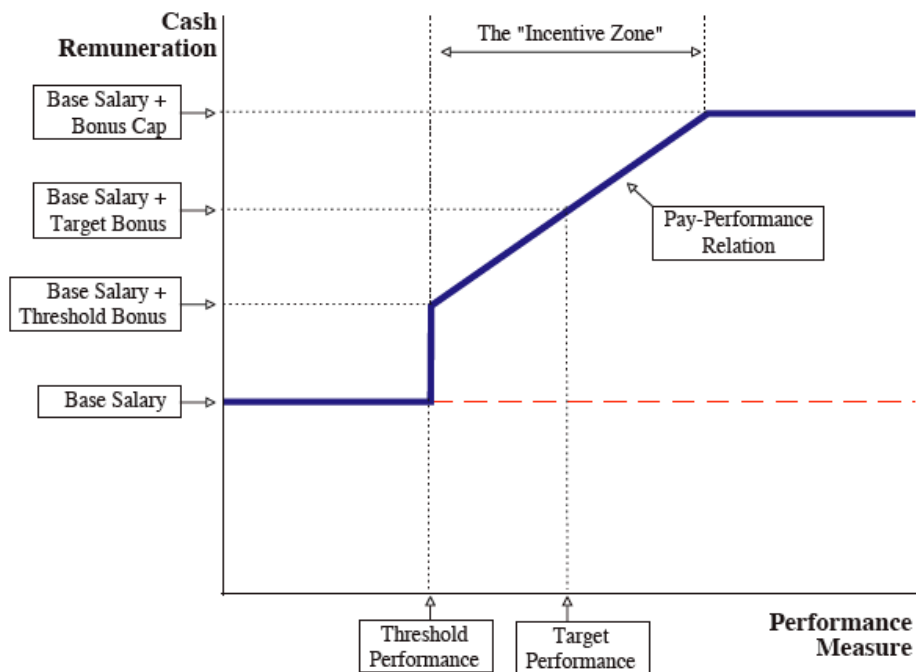
Diese Diplomarbeit präsentiert potentielle Lösungen für das Prinzipal-Agenten-Modell, d.h. bestimmte Mechanismen um die Interessen von Managern und Aktionären zu verbinden. In Zeiten einer globalen Finanzkrise wird der Anstieg der Vergütungen von Führungskräften heiß diskutiert. In diesem Licht werden tatsächliche Verdienstzahlen präsentiert, sowie die Entwicklung des Verhältnisses von Führungskraft- und Angestelltengehalt. Es werden zwei Ansätze zur Lösung des Prinzipal-Agenten-Problems entwickelt: Die Beobachtung oder Kontrolle des Agenten und das leistungsbezogene Anreizsystem. Da eine Kontrolle der Agenten im Sinne von Zeit und Geld meist sehr kostspielig ist, konzentrieren sich viele Firmen auf die leistungsbezogene Vergütung, welche die Bezahlung ihrer Geschäftsführer mit der Entwicklung der Geschäftszahlen verknüpft. Als eine besondere Form dieser Bonus-basierenden Vergütung wird das Model der relativen Leistungsbewertung (engl. relative performance evaluation) genauer untersucht.

Aktuelle Diskussionen beinhalten nicht nur Regulierungen der Managervergütung sondern auch Möglichkeiten zur Stärkung der Aktionäre. „Say-on-pay“-Modelle erfahren aktuell eine breite Aufmerksamkeit in vielen Ländern. Großbritannien war das erste Land, welches verpflichtende Aktionärsabstimmungen für börsennotierte Unternehmen einführt. 2010 folgte die USA dem Beispiel Großbritanniens mit der Einführung einer verpflichteten, aber nicht bindenden, Abstimmung für alle großen Unternehmen. Als sehr aktuelles Kapitel wird die vorgeschlagene Volksabstimmung über bindende Aktionärsabstimmungen in der Schweiz analysiert. Trotz der Begeisterung für „say-on-pay“-Gesetze unter den Investoren, gibt es auch Kritiker dieser Strategie. Negative Abstimmungen können auch beträchtliche Kosten für die Aktionäre beinhalten. Die Arbeitsleistung der Führungskräfte kann durch Befürchtungen minimiert werden, dass erwartete oder vereinbarte Vergütungen nicht ausbezahlt werden. Es existiert auch ein höheres Risiko für Branchen mit „say-on-pay“-Regulierungen, hoch qualifizierte Führungskräfte an Firmen in unregulierten Branchen oder sogar an Firmen im Ausland zu verlieren.

## 7. APPENDIX

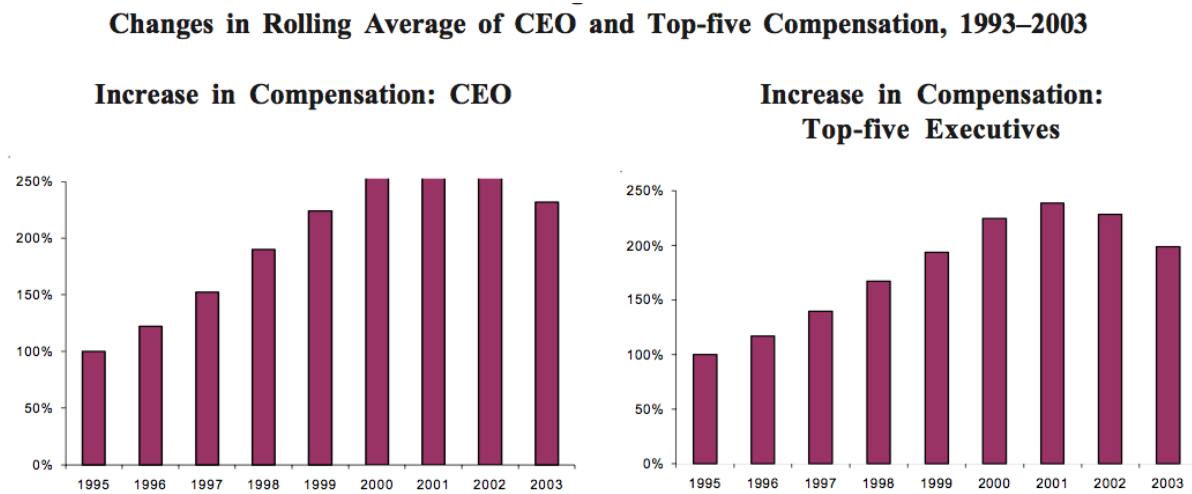
### 7.1. Figures

**Figure 1 – Base salary and bonus for a typical annual bonus plan**



Source: Jensen and Murphy (2004)

**Figure II – Increase in compensation of CEO and top-five executives**



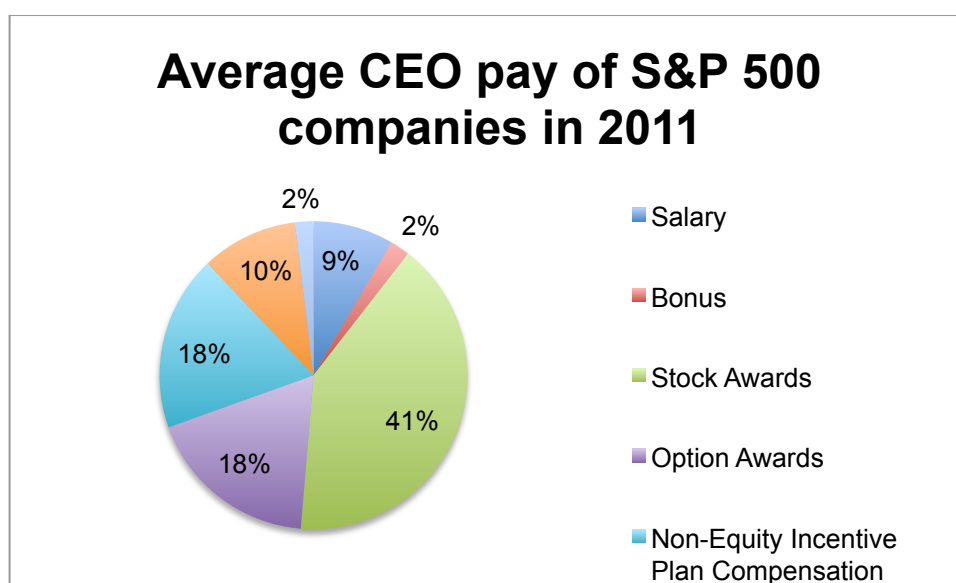
Source: Bebchuk and Grinstein (2005)

**Figure III – Average CEO compensation in 2011 (in the US)**

**2011 Average CEO Pay at S&P 500 Index Companies**

Salary	\$1,091,182
Bonus	\$268,110
Stock Awards	\$5,279,828
Option Awards	\$2,352,544
Non-Equity Incentive Plan Compensation	\$2,382,529
Pension and Deferred Compensation Earnings	\$1,308,625
All Other Compensation	\$252,657
<b>TOTAL</b>	<b>\$12,935,475</b>

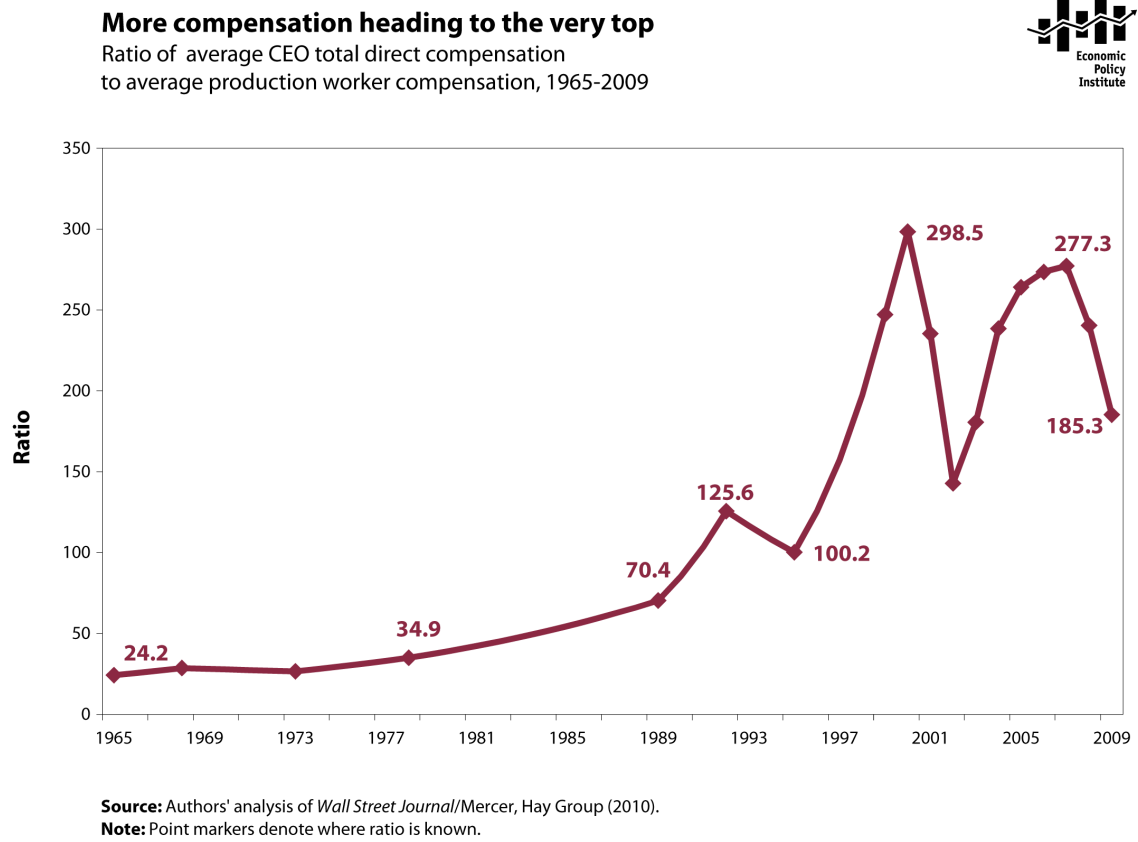
Source: American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) (2012)



Source: own illustration



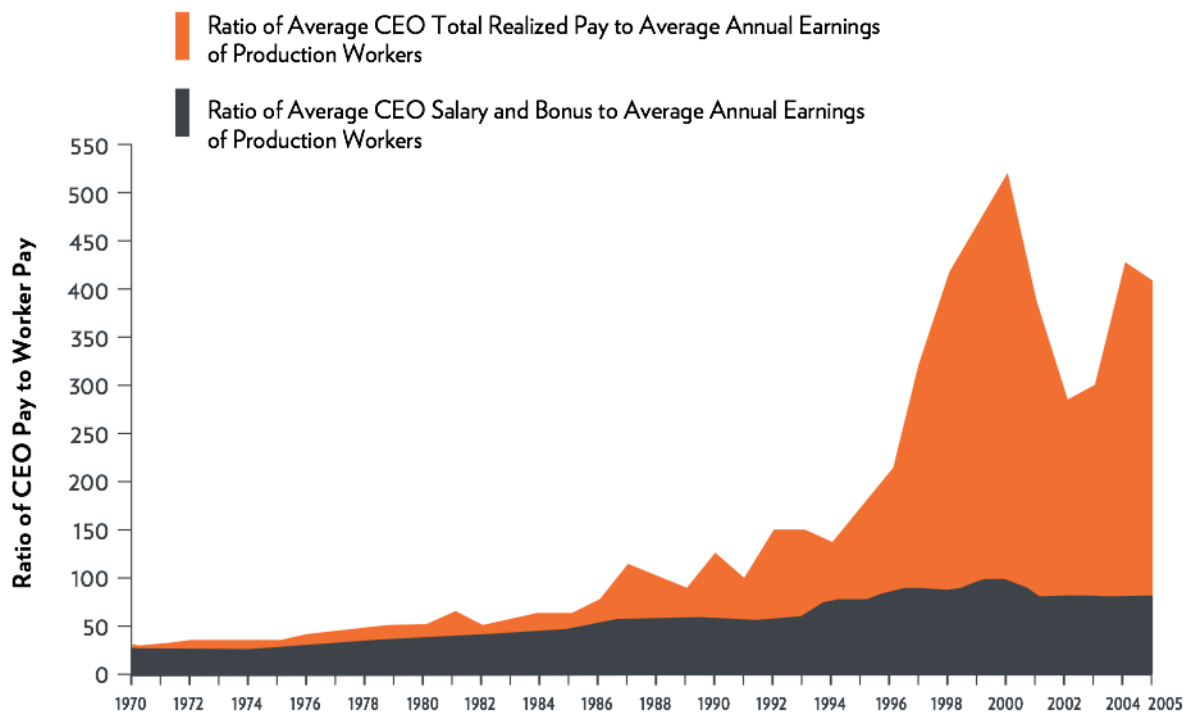
**Figure IV – CEO-to-average-worker pay ratio 1965-2009**



Source: The State of Working America, Economic Policy Institute (2010)

**Figure V – The rise of stock options in CEO remuneration**

**CEO Compensation As a Multiple of Average Worker's, 1970–2005**  
(S&P500)



Source : mise à jour de l'étude de Jensen & Murphy, ECGI, 2004 et 11th Annual CEO Compensation Survey, 2004.

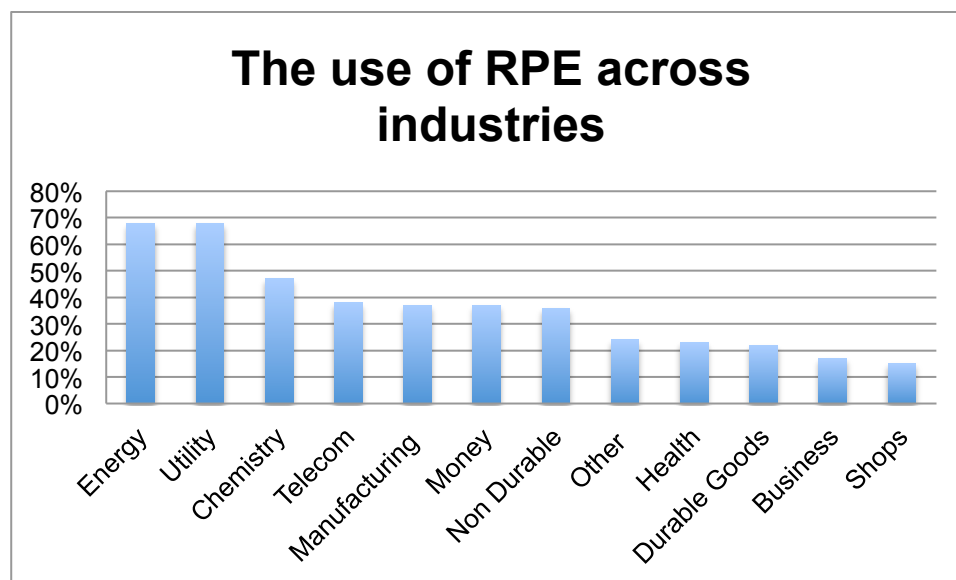
Source: Institute for Governance of Private and Public Organizations (2010)

# **Figure VI – The use of relative performance evaluation (RPE) in the US**

(from a sample of 494 S&P 500 firms in 2007)

Panel D: The Use of RPE Across Sectors				
Industry	Proportion of RPE users	RPE Weight among users		
		Mean	SD	Range
Non Durable Goods	36%	36%	15%	49%
Durable Goods	22%	45%	24%	33%
Manufacturing	37%	46%	27%	79%
Energy	68%	60%	28%	80%
Chemistry	47%	35%	15%	49%
Business Equipment	17%	46%	23%	62%
Telecom	38%	52%	32%	83%
Utility	68%	55%	19%	60%
Shops	15%	45%	17%	47%
Health	23%	57%	20%	59%
Money	37%	52%	27%	81%
Other	24%	44%	25%	74%

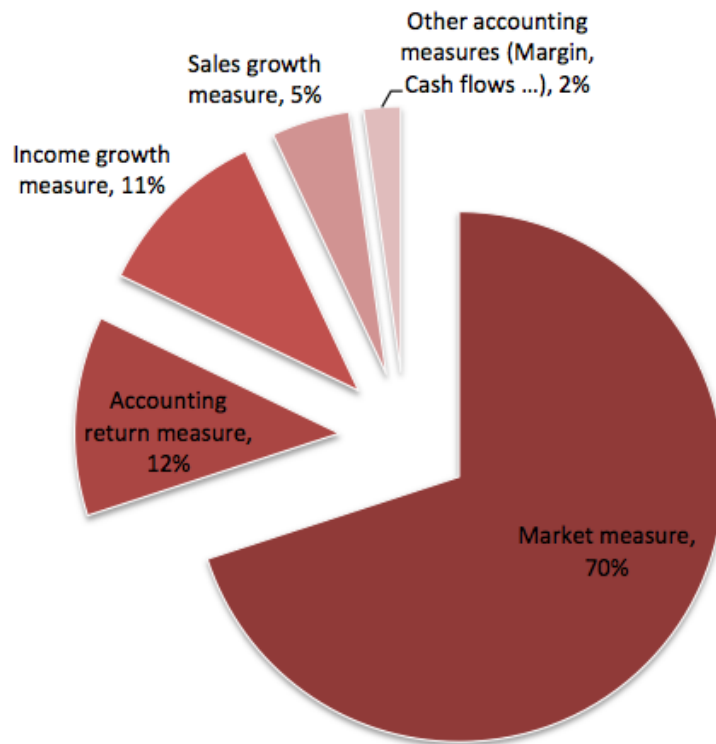
Source: De Angelis and Grinstein (2011)



Source: data taken from De Angelis and Grinstein (2011), own illustration

**Figure VII – Average weights of performance measures**

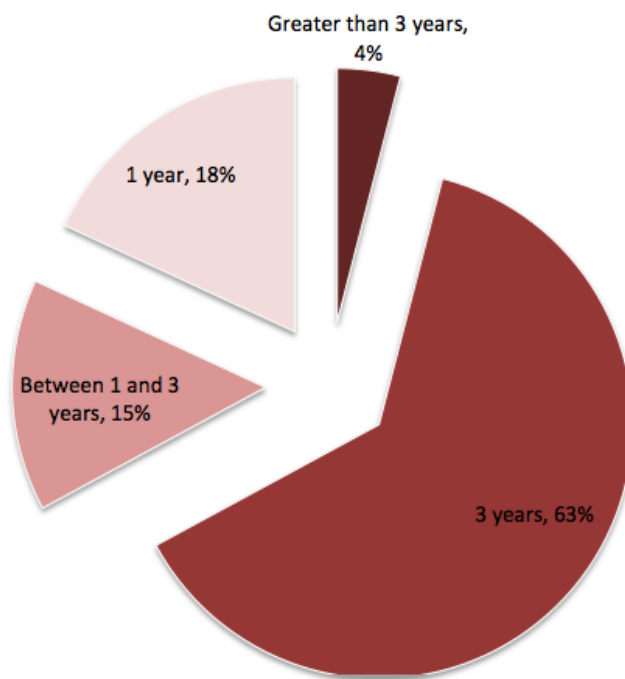
In the following figure, various types of performance measures associated with RPE are presented.



Source: De Angelis and Grinstein, 2011

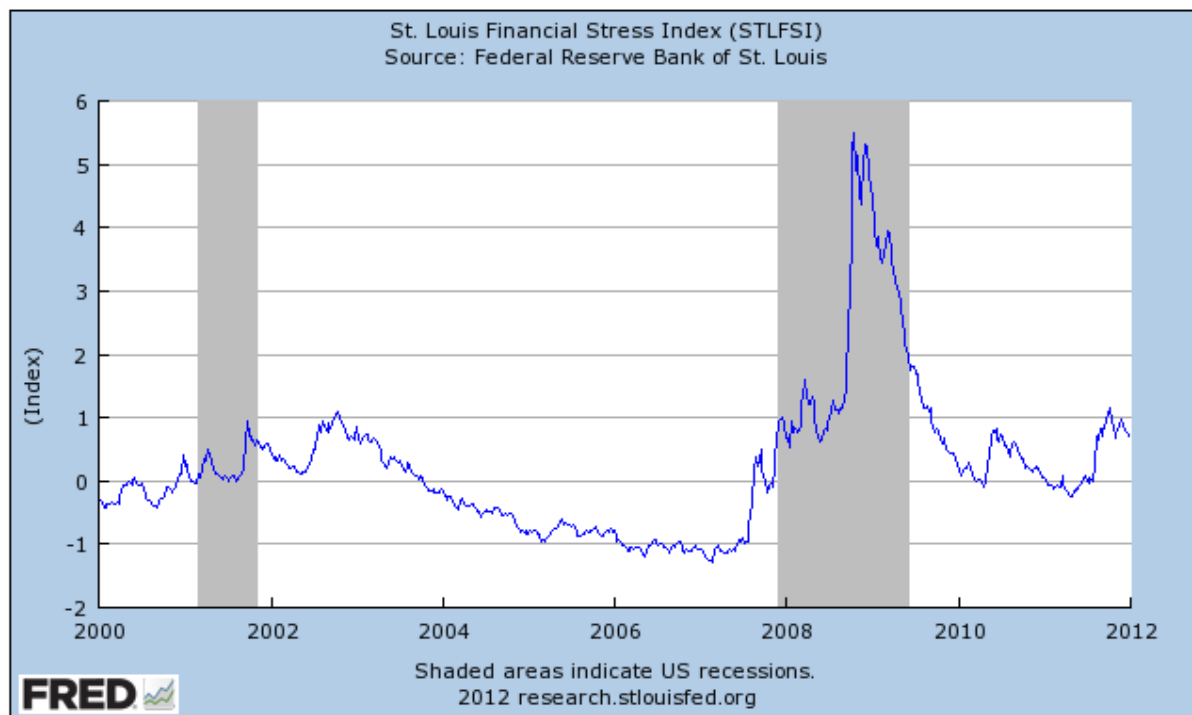
**Figure VIII – Distribution of the performance horizon**

In the following figure, the distribution of the performance horizon associated with RPE is presented.



Source: De Angelis and Grinstein, 2011

**Figure IX – Financial Stress Index 2000 – 2011**



Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED) (2012)

**Figure X – Models of say-on-pay in various countries**

Country	Year Adopted	Directors or Executives	Pay Policy or Structure	Binding or Advisory	Frequency	Required or Voluntary
United Kingdom	2003	Directors	Pay Structure	Advisory	Annually	Required
The Netherlands	2004	Executives	Pay Policy	Binding	Upon Changes	Required
Australia	2005	Directors	Pay Structure	Advisory	Annually	Required
Sweden	2006	Executives	Pay Policy	Binding	Annually	Required
Norway	2007	Executives	Pay Policy	Binding	Annually	Required
Denmark	2007	Executives	Pay Policy	Binding	Upon Changes	Required
United States	2011	Executives	Pay Structure	Advisory	Annually/ Biennially/ Triennially	Required
Switzerland	2013 (pending)	Directors	Pay Structure	Advisory	Annually	Currently Voluntary
Germany	None	Executives	Pay Structure	Advisory	Annually	Voluntary
Canada	None	Executives	Pay Structure	Advisory	Annually	Voluntary

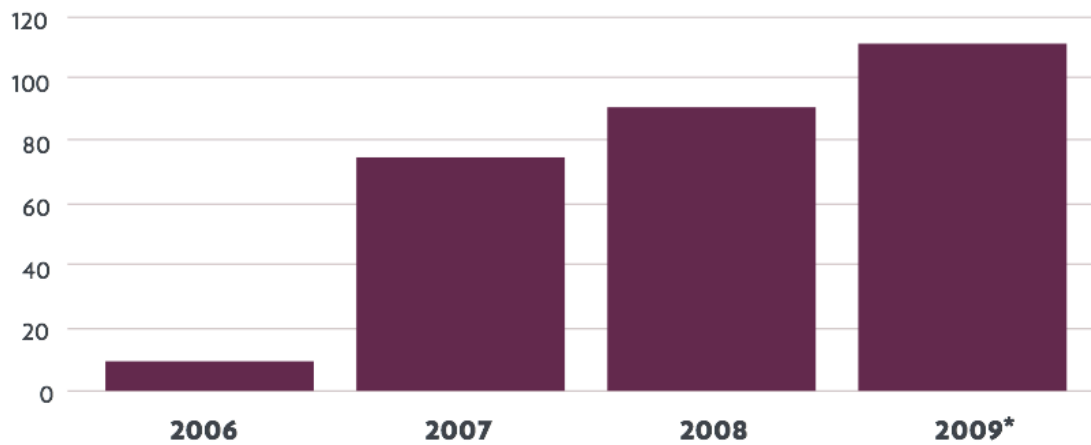
Note: “Year adopted” represents the year that say on pay first went into effect. Practices in countries with voluntary adoption vary.

Source: Larcker et al., 2012

**Figure XI – Number of requests for say-on-pay votes received in the US**

**I Say, I Say, I Say**

Number of requests for Say on Pay votes received in the US

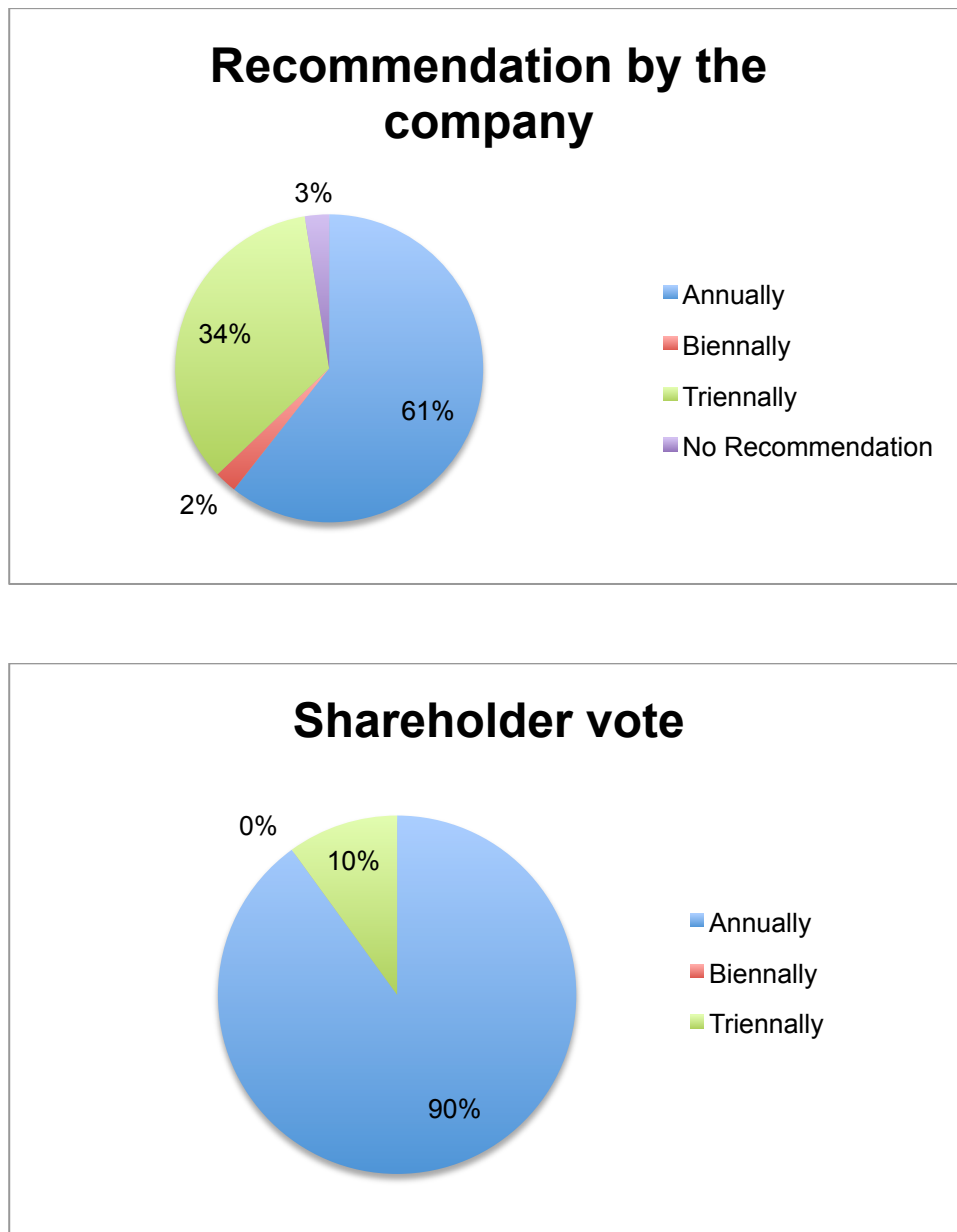


\*Year to May 15th  
Source: RiskMetrics Group

Source: Institute for Governance of Private and Public Organizations (2010)



**Figure XII – Frequency results on say-on-pay proposals**



Source: Data taken from Liu (2012), own illustration

## 7.2. Curriculum Vitae

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03/2008 – 04/2008

Praktikantin

Wirtschaftskammer Österreich – Wien

08/2007 – 02/2008

Assistentin im Bereich Messen/Außenwirtschaft

Going International – Wien

11/2006 – 02/2008

Marketing-Assistenz

Telekom Austria – Wien

08/2006 & 11/2005 – 01/2006

Business Solutions & Marketing Retail

Persönliche Fähigkeiten und Kompetenzen:

Sprachkenntnisse:

Deutsch (Muttersprache)

Englisch (fließend in Wort und Schrift)

Italienisch (Fortgeschritten)

Französisch (Grundkenntnisse)

EDV-Kenntnisse:

MS-Office (ECDL Computerführerschein)

SAP / CRM

Basiskenntnisse in HTML / PHP / SQL

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