BANKING ON CORPORATE

BY NEILL MAY

Too much ado about something

Is there such a thing as too much of a good thing? The phrase has appeared in both country music and Shakespeare, which is probably pretty rare (though one can imagine singing the words "as you like it," "all's well that ends well," or "exit, pursued by a bear" with a harmonica and a washboard), so it's likely true. One way to test the question more scientifically would be to write this column more frequently, but that would be, with characteristic modesty, more of a truly great thing.

The "good thing" that has captured my attention is executive compensation disclosure, the requirements for which have been regularly increasing. There are persuasive merits of the requirement that public issuers disclose what their top executives earn, which has been required in Canada in one form or another for almost two decades. Executive compensation disclosure, among other things, allows investors and other market participants to analyze the relationship between executive compensation and corporate performance; it forces companies to orient compensation frameworks towards the achievement of measurable goals and milestones; and it facilitates a more uniform accounting of compensation. Additionally, a disclosure-oriented requirement is generally preferable to inflexible regulation in matters such as compensation. The citizens of Switzerland seem to feel that way, having (as I write) just soundly rejected a national referendum that sought to limit senior executives' pay to 12 times their companies' lowest paid employee.

The question, however, is how much disclosure to require. This is where the principles of economics (in particular the law of diminishing marginal returns) and the wisdom of Shakespeare and country music intersect. My high school economics teacher explained this to me in terms of how much better the first slice of pizza tastes than the 12th. To take that example one step further, ordering pizza is good for one purpose, like providing some level of nutrition, but at some point it is not great for other purposes, say, impressing your first girlfriend.

The U.S. Securities and Exchange Commission released a proposal in the fall that, if adopted, will require U.S. public companies to disclose in certain public filings (a) the CEO's annual compensation, (b) the median annual compensation of all of the company's employees, excluding the CEO, and (c) the ratio of those two amounts. In other words, companies would need to disclose how many times more than the median employee the CEO makes each year.

Disclosure of this ratio is not a new thing, or in all cases a bad thing. For certain companies (most famously Ben and Jerry's before its acquisition by Unilever) maintenance and disclosure of a low ratio can help demonstrate a certain corporate ethos or type of work environment, or project a public image that might appeal to certain constituencies (particularly customers interested in supporting companies with a socially conscious or responsible façade).

However, the benefits of disclosing this golden ratio are not as clear in the context of securities regulation. Senior executives are ultimately responsible for corporate performance, and so clearly disclosing their compensation so it can be measured against the value delivered, and so its structure can be assessed to see that executives' interests are properly aligned with stakeholders, makes sense. What is more difficult to discern is the value of disclosing, in a vacuum, how much a regular employee makes and doing some simple arithmetic to relate that number to the CEO's pay. Companies function in different industries, with different cost structures, different employee populations (in terms of training, experience, and other factors), and different organizational structures. Different ratios between companies may tell investors nothing about what must be the bottom-line question: Is the executive being fairly and properly compensated (given the value delivered, or not), in a manner that best serves the interests of the issuer? The rules might just as well require companies to disclose the ratio of hours spent working by the CEO and the median employee, or the number of work-related e-mails per day.

It is difficult to argue against more disclosure. Disclosure increases transparency, the marginal costs should be manageable, and arguing against it makes it look like you're sheltering something. But where the disclosure in isolation is potentially misleading, and may create more distraction than focus on key issues, it bears consideration.

There is something ironic about a world where the news has been reduced to bursts of not more than 140 characters, but disclosures keep getting longer and more detailed. So is it true that there can be too much of a good thing? To quote Shakespeare again, in another phrase that could be featured in country music (perhaps with mild adjustment), "an overflow of good converts to bad." I am not certain I have answered the question. But in the interests of science and humanity I am prepared to volunteer myself to test it. I would use Ben & Jerry's ice cream, if only I knew what they paid their CEO. CL

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