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Executive Compensation & Corporate Governance

Insights 2017 - Part 1

*A study examining
compensation in SMI,
SMIM and small-cap
companies as well as
trends in corporate
governance*

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ExCo Insights 2017, part 1

How have pay levels of executives and board members developed over time? Are there differences across industries? What are the main trends in pay structure? Is there a connection between pay and performance, or is pay decoupled from actual delivery of results for shareholders and other stakeholders? What performance criteria should be relevant for determining pay? How should companies communicate with shareholders, employees, the media, and society at large?

To help answer these questions, and to engage PwC clients in a dialogue, every year for over a decade PwC has presented one of the most detailed Swiss studies available on the level and structure of board and executive compensation. We are delighted to present the eleventh edition of our study “Executive Compensation & Corporate Governance Insights”. This study comprises the years from 2007 to 2016 and is based on the largest 100 listed Swiss companies.

This year, we present the outcomes of the study in a few shorter Insights releases (though the longer studies from prior years remain available online). The notes are, however, closely related, and we hope that you will enjoy the breadth of perspective offered when considering them as a whole:

1. Insights 2017, part 1, released in October 2017, studies the level of compensation of CEOs, other executives, and chairmen and other board members in Swiss listed companies, and thus provides valuable insights for board members and executives seeking the right quantum of compensation.
2. Insights 2017, part 2, released in November 2017, investigates the question that has led to emotional discussions: do Swiss executives get paid for performance? Understanding the facts helps board members and executives benchmark the situation in their own companies
3. Insights 2017, part 3, released in December 2017, covers new methods of pay design and an analysis of the demands of shareholders in the upcoming annual general meeting season. This analysis helps companies to prepare for communication with stakeholder.

We look forward to engaging in dialogue with you.



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Introduction Insights 2017, part 1

PwC's Exco Insights 2017, part 1, summarizes the key highlights for the largest 100 Swiss listed companies regarding the level of compensation of CEOs and other executives, as well as chairmen and other board members. Then, it studies the much-discussed differences between financial services (FS) and non-financial services (non-FS) companies – and unearths some arguably surprising patterns.

The key findings are:

1. Total CEO compensation in the largest 100 companies has increased markedly over the past few years. From 2009 to 2016, median total CEO compensation has increased by 41.2%, 67.0% and 12.1% for SMI, SMIM and small-cap companies, respectively.
2. CEO compensation in SMIM companies is catching up with compensation in SMI companies – but a divergence is seen in compensation of CEOs at SMIM and small-cap companies.
3. The overall rise in executive compensation since 2009 has mostly been driven by non-financial-services (non-FS) companies rather than FS companies. For example, median CEO compensation in non-FS SMI companies has increased by roughly 50% since 2009, while it has actually fallen by around 27% in FS companies.

Our data facilitate a wealth of other analyses. Here we highlight only a few key points, but we are happy to engage with you in a dialogue about aspects of compensation which are of particular interest to you.

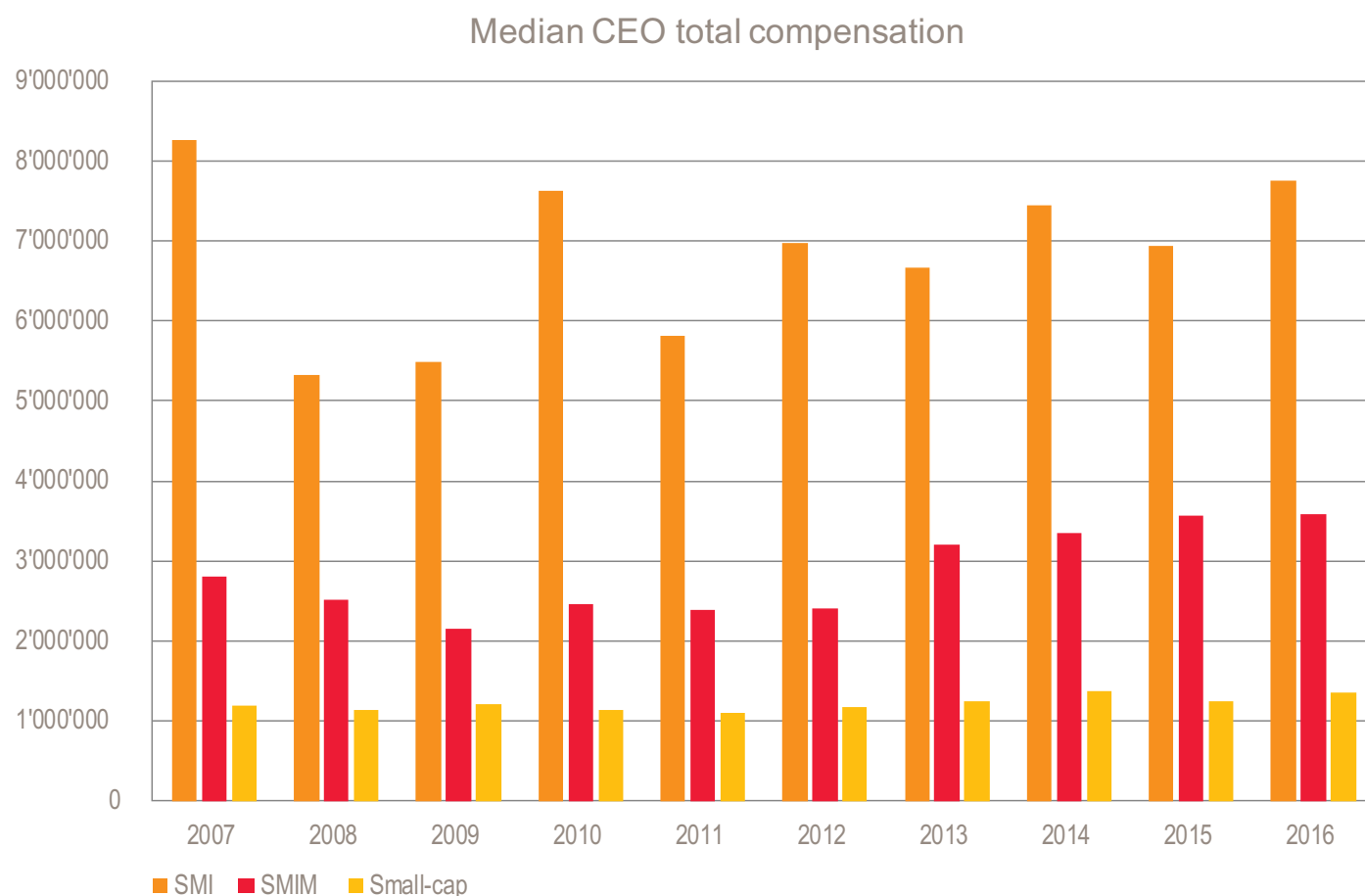
Exco Insights 2017, part 2 studies pay-for-performance in Switzerland. Exploiting the long time period and the large sample, that note shows that, contrary to some recent claims, a working pay-performance relationship exists in Swiss companies.

Exco Insights 2017, part 3 covers new methods of pay design and an analysis of the demands of shareholders in the upcoming annual general meeting season.

Compensation levels in SMI, SMIM, and small-cap companies

- Taking 2009 as the reference year, median total CEO compensation has increased through 2016 by 41.2%, 67.0% and 12.1% for SMI, SMIM and small-cap companies, respectively. The median total CEO compensation of SMI companies is now CHF 7.7 million, whereas in 2009 it was CHF 5.5 million. In SMIM companies it was CHF 3.6 million in 2016 versus CHF 2.2 million in 2009. In small-cap companies it was CHF 1.4 million vs. CHF 1.2 million in 2009. Figure 1 illustrates these striking developments. This figure also shows that 2007, the last year before the financial crisis, was “special”: SMI and SMIM firms in particular appear to have experienced unusually high executive compensation in that year.
- What Figure 1 does not show is that extremely high CEO compensation levels (above CHF 20 million), prevalent in a few SMI companies in the years 2007-2009, have vanished in recent years. Therefore, the average CEO compensation in SMI companies, at CHF 7.66 million, is slightly lower than in 2009, when it was CHF 7.73 million. In SMIM and small-cap companies, average compensation is now CHF 3.9 million and CHF 1.7 million, respectively, up 36.0% and 16.8% from 2009. (These numbers are not shown in the figure, but the detailed statistics are available on request).

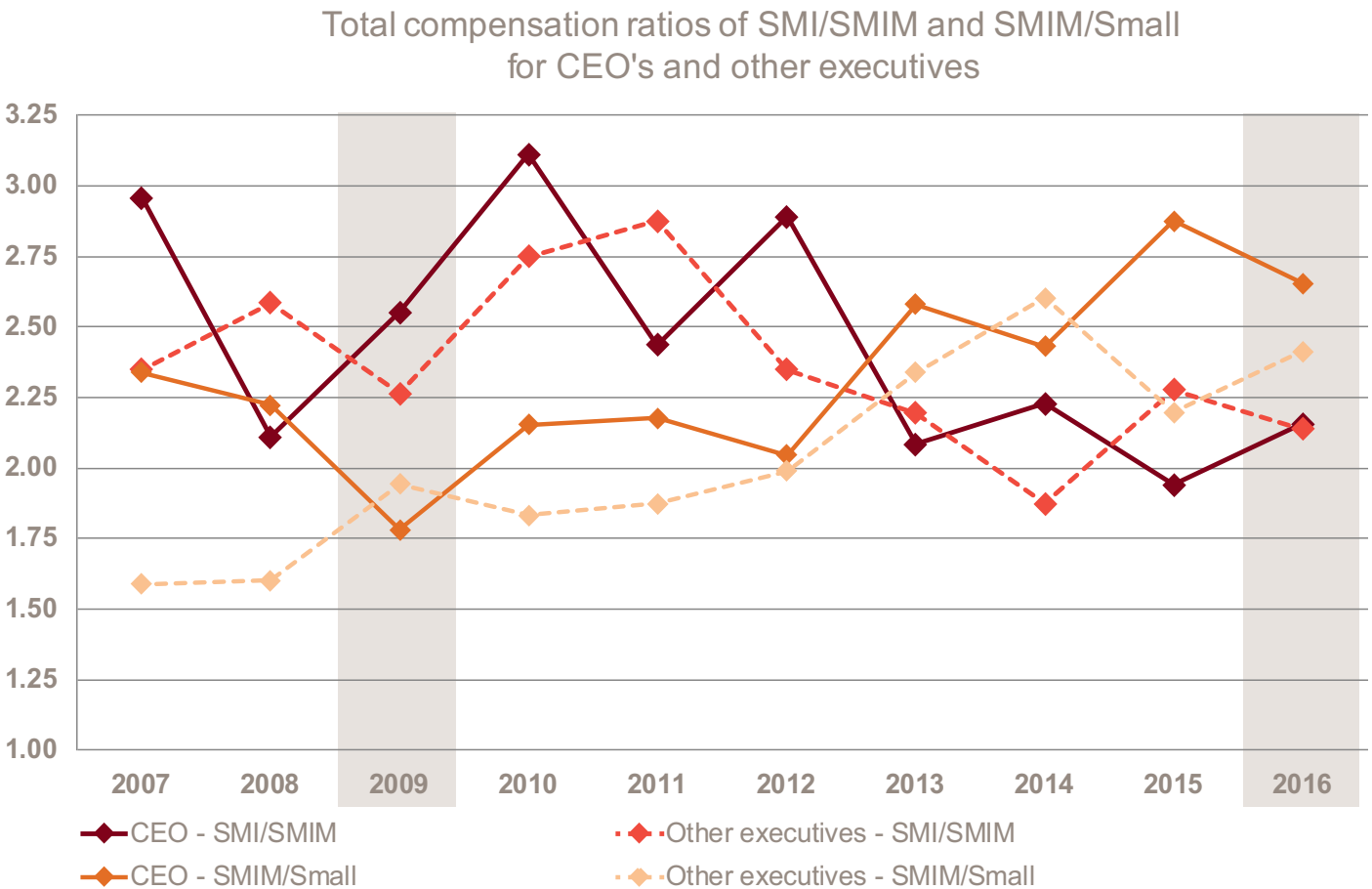
Figure 1: From 2009 to 2016, median total CEO compensation increased by 41.2%, 67.0% and 12.1% for SMI, SMIM and small-cap companies, respectively.



- When assessing compensation levels, it is also important to keep structural differences in mind. These differences are discussed in PwC Exco Insights 2017, part 2.

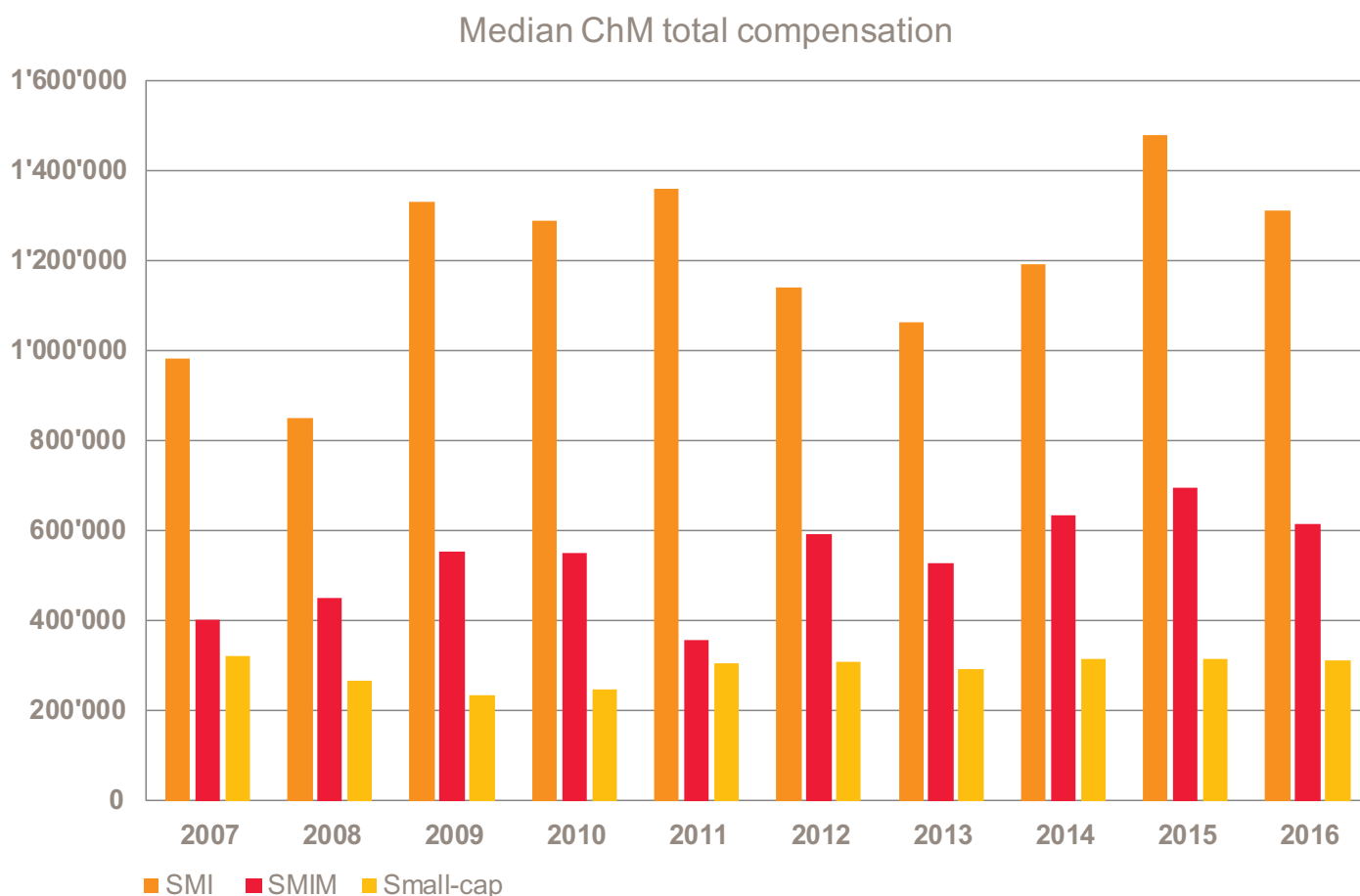
- Figure 1 shows that it is still the case that larger companies pay substantially higher total compensation. What we are also observing, however, is that CEO compensation at SMIM companies is catching up significantly with CEO compensation at SMI companies – and a divergence of compensation at SMIM and small-cap companies is being seen. Figure 2 illustrates this point. The two solid lines show that the median SMI CEO earned, in 2009, 2.55 times what the median SMIM CEO earned, and the median SMIM CEO earned around 1.78 as much as the median small-cap CEO. By 2016, the first number had fallen to a multiple of 2.16, while the second had increased to a multiple of 2.65. A qualitatively similar development can be observed for other executives, as shown by the dashed lines.

Figure 2: SMI and SMIM CEO compensation is converging – but a divergence is seen in compensation of CEOs at SMIM and small-cap companies.



- While this note focuses on executive compensation, we have also analysed data for chairmen and board members. Briefly, from 2009 to 2016, median non-executive chairman compensation remained stable for SMI companies, at around CHF 1.3 million, though this is substantially above the 2007 level (CHF 1.0 million). In SMIM companies, chairman compensation has increased by 11.0% from around CHF 554,000 in 2009 to around CHF 615,000 in 2016. A major increase took place from 2007 to 2009, when compensation was CHF 403,000 at the median. In small-cap firms (the next largest 50 companies), median chairman compensation remained at around CHF 311,000 this year, 32.4% above the 2009 level, and similar to 2007. Figure 3 illustrates these findings.
- The remuneration of other members of boards of directors who have no executive functions has remained more or less the same since 2007 (and 2009) among SMI companies, and increased for SMIM and small-cap firms. In 2016, the median board member of an SMI company received about CHF 300,000 (+1.0% since 2007, -2.6% since 2009), the median board member of an SMIM company about CHF 212,000 (+25.1% since 2007, +29.3% since 2009), and the median board member of a small-cap firm CHF 126,000 (+16.6% since 2007, +41.5% since 2009).

Figure 3: In SMIM and small-cap firms, chairman compensation has been increasing since 2009



Analysis by company sector: financial services (FS) vs. non-FS companies

The financial services (FS) sector, such as banks and insurance companies, is of great importance to Switzerland. At the same time, when it comes to compensation, this sector has received the greatest criticism. Together with some of the pharma companies, several of the biggest financial institutions have been in the spotlight of the media and have received critical public attention. Some would argue that the resounding acceptance of the Abzocker-Initiative in 2013 was largely driven by a perception of disproportionate executive compensation in the financial sector, especially in light of the financial crisis.

What is actually the evidence on compensation in the FS sector versus the other sectors? Of course, such an analysis is challenging because of the relatively small sample size. For example, in 2016, there were 6 SMI, 6 SMIM, and 18 small-cap FS companies. Lumping all 30 of them together and comparing them with the around 70 non-FS companies is not possible due differences in size. Still, the question of differences in pay across sectors is of great importance, and we therefore seek to stimulate a discussion of this question with the following data, exerting the necessary caution against too definitive generalisations. We also emphasize that with this data we can make no statements about compensation outside the executive compensation ranks, as no such compensation is typically disclosed in a manner that allows meaningful comparisons. Computations of average wages per employee are difficult due to lack of comparable employee numbers data.

Table 1 illustrates a familiar picture – but also facts that may be surprising. First, in 2009 at the largest companies, the SMI firms, median compensation of CEOs and other executives in the financial services firms was substantially higher – indeed twice as high or even two and a half times higher – than median compensation of such executives in non-FS firms. We suspect that this observation has cemented itself in the public perception. SMI FS firms still pay their CEOs and other executives more than SMI non-FS firms in 2016. However, the table shows that the difference is now much smaller, with a pay differential of roughly 20%.

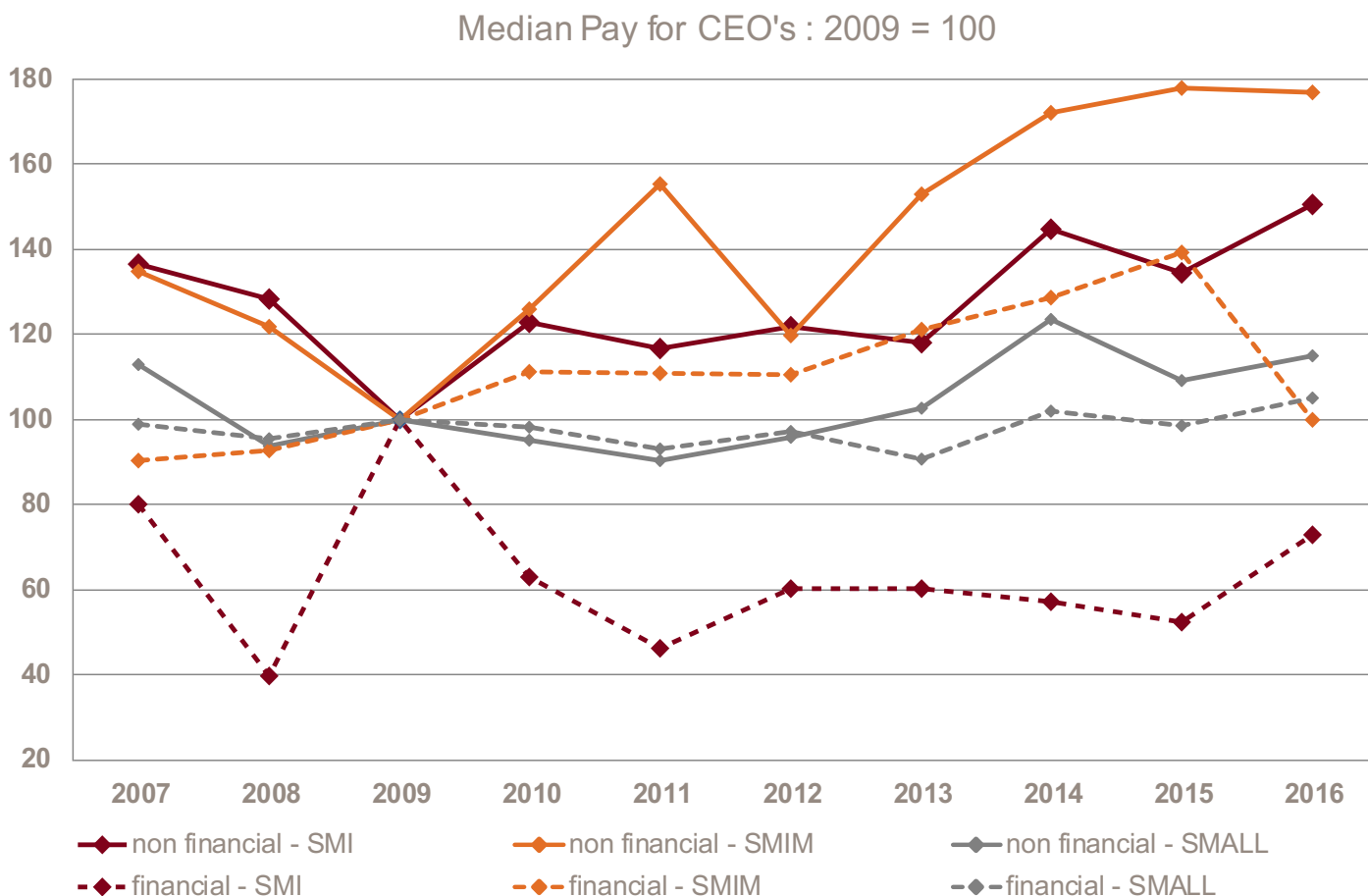
Second, outside of the SMI companies, total compensation of FS-firm CEOs and other executives in 2016 was lower than in non-FS firms. For example, the median small-cap financial services CEO earned CHF 1.2 million, while the median non-FS CEO in this size class earned CHF 1.4 million. Even in 2009, CEOs earned about the same in the two sectors. Of course, the small-cap FS sample comprises some cantonal banks, but this analysis serves to illustrate the point that the broad generalisation that the financial services sector as such is higher-paying for executives than other sectors is not always accurate.

Table 1: Median executive compensation (in CHF) – some surprising facts

		2009			2016		
		SMI	SMIM	Small-cap	SMI	SMIM	Small-cap
CEOs	FS	12,597,000	2,151,000	1,141,985	9,192,500	2,151,909	1,198,000
	Non-FS	5,150,096	2,109,900	1,249,500	7,746,511	3,731,000	1,435,276
	Ratio	2.45	1.02	0.91	1.19	0.58	0.83
OEx	FS	5,722,143	1,200,500	695,183	4,182,178	1,504,758	687,527
	Non-FS	2,755,792	1,237,402	580,225	3,537,919	1,702,541	688,756
	Ratio	2.08	0.97	1.20	1.18	0.88	1.00

Most importantly, consider the changes over the years, as illustrated in Figure 4. This figure indexes CEO compensation to a level of 100 in 2009 for each of 6 groups: 3 size groups (SMI, SMIM, small-cap) and 2 sectors (FS and non-FS). The non-FS firms are the solid lines. This figure makes it easy to identify growth (above 100) and decline (below 100) in compensation.

Figure 4: Non-financial services companies – not banks and insurance companies – have been driving the increase in CEO compensation since 2009



Strikingly, all three solid lines end up substantially above 100% in 2016, meaning that non-FS companies have experienced significant CEO compensation growth. By stark contrast, the three dotted lines show that CEO compensation in FS firms either dropped sharply in the years 2010 and 2011 and has stayed stable since then (in the case of SMI firms), or it has increased, but not nearly as fast as non-FS firms, with a big drop in the final sample year (in the case of SMIM firms), or it has remained essentially flat (as in the case of small-cap firms).

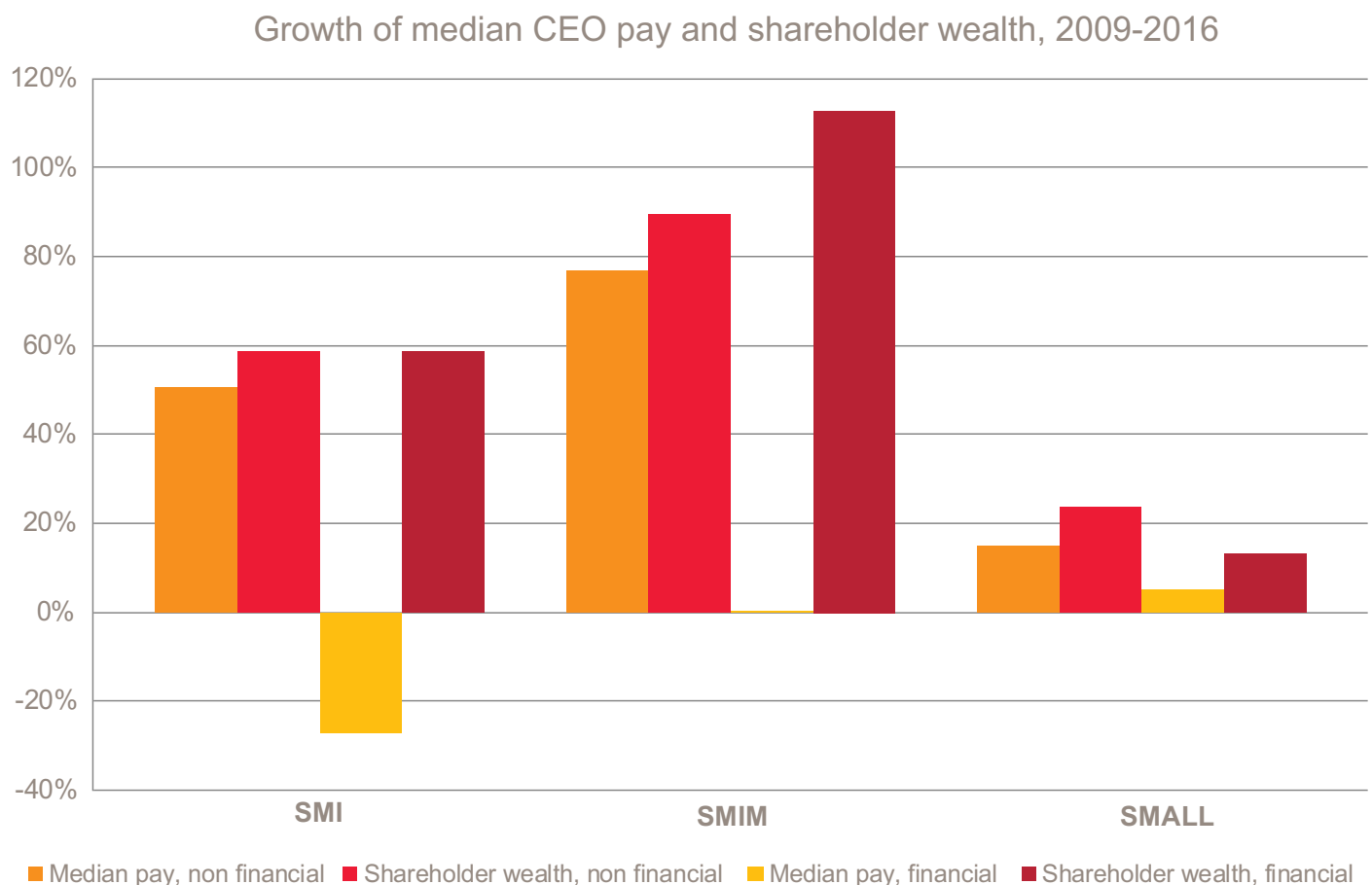
In sum, this analysis shows that executive compensation in non-FS companies has increased substantially faster than compensation in FS companies. Indeed, the overall trends in compensation observed at the beginning of this note are driven not by banks and insurance companies but by companies in the other sectors of the Swiss economy.

Summary and outlook

In short, this analysis shows that executive compensation has developed dynamically in Switzerland in the last 11 years. Important pre-conceptions – for example, that executive compensation in the financial services sector is always higher than in the other sectors – does not hold up against actual analysis of the data once the sample is extended outside the few largest companies that many other studies consider.

Of course, when assessing compensation, a key issue is not only the level of compensation, but also the structure of compensation, and how (variable) pay relates to the performance of the company. Insights 2017, part 2, covers this topic in more detail. For now, consider Figure 5 as a “teaser”. It plots the growth rates in median CEO pay against growth in shareholder wealth, measured as median total shareholder returns (capital gains and dividends) in the respective groups. As seen above, compensation in non-FS firms grew faster than in FS firms. The main insight to be gleaned from the figure is that shareholder wealth grew faster than CEO compensation in each subsample. (In SMI and SMIM companies total shareholder returns in FS companies have actually, at the median, been as high or greater than returns in non-FS companies. Of course, here we need to keep in mind that share prices of FS companies after the financial crisis were arguably significantly lower.)

Figure 5: Shareholder wealth has grown faster than CEO compensation since 2009



This aggregate analysis suggests that overall executive compensation and shareholder wealth have moved together when considered over a long time period (or that, indeed, shareholders tend to have seen greater growth in their wealth when compared to the rate compensation has grown at). However, this does not necessarily say much about the pay-performance relationship at individual company level, and it does not say anything about the link on a year-by-year basis. Is there pay-for-performance when we look more closely? Find out in PwC Insights 2017, part 2.

