Executive Compensation in Switzerland:
Some observations on recent market trends

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Compensation in the limelight (Slide 2)

Reality in the executive market today in Switzerland is that compensation continues to be a matter of discussion, even controversy, among market players, investors, academics, media and the public at large. Debates continue on how to shape, or to optimize, the incentive structures for top decision makers in publicly listed corporations.

Criticism, not only in the popular media, but also in the economic and financial communities, abounds over senior executives being shamelessly overpaid: when benchmarked against peers across Continental Europe or with their own firm’s performance, a number of Swiss-based executives may indeed appear to be rewarded to an excessive level. But more importantly, criticism currently tends to shift away from absolute compensation amounts (most of which are, by the way, matched or even surpassed by remuneration earned by sports or entertainment stars, such as Michael Schumacher, David Beckham, Britney Spears, and Tom Cruise). Instead, it is rather concentrating on the ratio of chairmen, CEO or senior
executive pay to employees, which, in the last 10-15 years, has grown in Switzerland from around 30-50 : 1 to a ratio of around 180-250 : 1.

As regards Switzerland, undoubtedly, executive pay is still suffering from an insufficient degree of transparency on its constituent elements, and especially on how they are linked to strategic performance. Very often, the underlying assumption is that top managers have a disproportionate influence on corporate performance and the leverage to direct their firm’s strategic destiny. Executive compensation plans are thus labelled as strategic reward systems.

**Conceptual issues in executive compensation (Slide 3)**

Linking executive pay to performance is surprisingly difficult, because it is not easy to define proper measures of achievements. Indeed, executive pay has numerous dimensions. Some of them (with a particular importance in Switzerland, e.g. company car, club membership fees) defy any attempt to be assigned to a specific performance measurement. Other components, such as stock options, can vary over time: should pay be calculated at the time the options are granted, at the time they are exercised, or even at the time the exercised options are sold by the beneficiary? Similar problems exist in the interpretation of deferred compensation, pension contributions or golden parachutes. Even more difficult to interpret are perquisites where the cash value may be secondary, but the symbolic meaning highly important.
Clearly, compensation is only one of a variety of incentives for top managers. The achievement of power and status rival compensation in terms of importance for executives. It is therefore obvious that one should look not only at the level of compensation, but also at its profile and components to assess whether it is appropriate. Besides, each compensation package contains a time and a risk element, both of which impact its true value for the recipient.

Another conceptual difficulty, particularly in Switzerland, in assessing executive compensation lies in the assumption that performance in general, and strategic performance in particular, can be readily articulated. This is far from obvious. Usually, firms resort to financial, operational and accounting indicators (e.g. ROI, ROE) in selecting the criteria for decisions regarding executive compensation. When trying to evaluate performance from a strategic perspective, firms tend to extend such indicators over a multi-year period, assuming that elongating the time frame makes such performance measures strategic. As an alternative, some Swiss-based firms have recently tended to substitute capital market measures for accounting performance, assuming that market-derived performance indices are less likely to be manipulated. Whether such compensation schemes deserve the label “strategic” is not quite evident.

Measuring performance for top executives (Slide 4)
Today, the most important measure of top executive performance, in Switzerland as elsewhere, is the creation of shareholder wealth. For a decade, shareholder value at publicly-listed corporations had been widely, if not exclusively, related to the company’s share price and market capitalization. The stock market recession of 2000-2002 contributed heavily to the modification of this somewhat biased view. Today, executive performance is frequently measured by the free cash flow available, as well as the growing earnings over the company’s cost of capital. However, certain organizations do not think that generating shareholder value is a sufficient measure of a top executive’s performance. Many Swiss firms are increasingly using intermediate measures that they believe help lead the creation of quality earnings and value. Beyond pure financial performance, they see a strong correlation between factors like customer loyalty, service quality, employee satisfaction, operational stability, sustainable growth and the bottom line. An increasing emphasis is being placed on the quality and credibility of people management. Qualitative criteria thus play an increasing role in executive compensation strategies.

**Determining executive compensation (Slide 5)**

In Switzerland, executive compensation is usually determined by the board of directors, or its remuneration committee. Besides internal criteria related to executive performance, the bodies in charge of finalizing decisions on executive pay often benchmark their decisions against various
compensation surveys, now broadly available in the market. Some academics believe that leading firms specializing in executive compensation are having an exaggerated influence on how compensation levels in this country are determined, and are liable to push overall executive pay up to unduly high levels. This might be true in certain specific areas. Our experience in executive recruiting suggests, however, that market forces are still, and will predominantly remain, the driving elements impacting decisions on executive pay. True, one should be aware that the recipients of executive pay often have a major impact on the design of their own compensation profile, i.e. how it is administrated and by whom it is enforced. The personal relationships between CEOs or other executives on the one side, and board members on the other, can play a significant part in deciding compensation levels – not least when, as sometimes happens in Switzerland, they reciprocate in sitting on each other’s boards.

**Switzerland in a benchmarking perspective (Slide 6)**

An international comparison based on a sample of OECD countries, referred to in Towers Perrin, shows that in 1999 compensation practices in Switzerland had moved in the direction of the U.K. and the U.S.A., although still falling short of US and, partly UK levels. On a scale of 100 representing the total average CEO remuneration of a sample of representative US corporations, the CEOs of corresponding European firms used to earn a total of 60 in the UK, 48 in France, 45 in Italy, 44 in Switzerland, 42 in the Netherlands, 37 in Germany and 31 in Spain.
Another survey, run by Mercer Human Resources Consulting in 2004, calculated the average compensation of senior executives in Europe based on their purchasing power, i.e. taking account of tax, social security deductions and local cost of living. Whereas the average remuneration in Western and Eastern Europe, adapted to a purchasing power index, amounts to 3.6, executives in Switzerland are scoring highest with 6.4, ahead of their peers in Germany (5.6), Austria (4.6), the Netherlands and Spain (4.3), Ireland and the U.K. (4.2), France (4.1) and Italy (3.7).

Of course, these figures also reflect the combination of financial compensation, tax levels, perceived value of CEOs and cultural differences among the above mentioned countries. An interesting indicator of the differences influencing executive compensation can also be seen in the total amount of company contributions (compulsory and voluntary), built in executive total remuneration. Here again, a comparison at CEO level shows that where company contributions will amount to 8 percent of executive remuneration in the U.S.A., it will amount to 22 percent in the U.K. and France, 21 percent in Italy, 17 percent in Switzerland, 14 percent in Germany and 13 percent in Spain and the Netherlands.
It is difficult to draw clear conclusions from these or other types of quantitative compensation surveys; they tend to illustrate trends rather than absolute facts. However, our own executive search experience reinforces the view that executive pay in Switzerland ranks amongst the highest in Europe, even if it still clearly lags behind corresponding levels in the U.S.A. and, partly, the U.K.

This probably reflects that:

- most figures in publicly available surveys stem from research focusing on publicly listed companies. Privately held corporations in Switzerland tend to offer far more modest levels of executive compensation, for which there is no broadly researched international comparison

- in Switzerland, political, legal and social criticism and pressure on executive compensation have been less stringent, at least until recently, than in most other European countries, with the result that market forces have been less constrained by external factors than, for example, in France, Germany or Italy

- Switzerland – and this is often unknown or forgotten – is the country in Europe that demonstrates by far the highest proportion of foreigners on boards of directors and executive committees. Research performed by Spencer Stuart in 2002 showed that among the 40 largest corporations in Switzerland, close to 30% of their board and almost 50% of their executive committee members were
foreign citizens (mainly from Germany, the U.K. and the U.S.A.), whose levels of compensation need to be aligned with those of their country of origin if they are to be incentivized to join a Swiss-based entity.

Conclusion

Executive compensation is a complex issue, far more so than most media and political representatives might think. Conceptual dimensions, performance measurement and the identity of those determining executive pay cannot be reduced to a few simplified elements before assessing and judging what is right and wrong.

As regards Switzerland, executive pay tends to be among the highest in Europe, at least for publicly listed companies. Although certain aspects attract some justifiable criticism, executive compensation in Switzerland still mostly reflects market forces, not least regarding shareholder value creation and high foreign representation on boards and executive committees.

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