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# The Globalization (Americanization?) of Executive Pay<sup>\*</sup>

Brian R. Cheffins<sup>†</sup> and Randall S. Thomas<sup>‡</sup>

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## The Globalization (Americanization?) of Executive Pay

Brian R. Cheffins and Randall S. Thomas

In the United States, the remuneration packages of top executives are characterized by a strong emphasis on pay-for-performance and by a highly lucrative “upside.” There is much discussion of the possibility that executive pay practices will globalize in accordance with this pattern. This Article assesses whether such convergence is likely to occur.

After surveying briefly the key components of managerial remuneration and after examining the essential elements of the “U.S. pay paradigm,” the Article considers market-oriented dynamics that could constitute a “global compensation imperative.” These include wider dispersion of share ownership, more cross-border hiring of executives, growing international merger and acquisition activity, and expansion of business activity by multinational enterprises. The Article will also take into account possible obstacles to the Americanization of executive pay. These could arise from various legal sources (such as corporate law, tax rules, and labor law) as well as “soft law” and “culture.” It must be recognized, however, that law could foster as well as hinder a move toward U.S.-style remuneration. For instance, the introduction of tougher disclosure rules seems particularly likely to have this effect.

This Article does not assess in detail whether the Americanization of executive pay would be a “good thing.” It makes a normative contribution, however, by identifying obstacles policymakers should address if they want to promote convergence. It also draws attention to strategies regulators might adopt if they conclude that a move towards U.S.-style compensation arrangements would be a mistake.

### I. INTRODUCTION

It has been said that executive pay “is the most intractable conundrum in global corporate governance.”<sup>1</sup> To the extent that this is accurate, one factor has served to complicate matters more than any other. This is the growing influence of the “U.S. pay paradigm,” characterized by highly “incentivized” and lucrative compensation arrangements.<sup>2</sup> Allegedly, a “global compensation

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1. John Plender, *An Assault on Boardroom Excess*, FIN. TIMES, Mar. 14, 2001, at 23.

2. Michael Cave, *I'm Worth It, Baby*, AUSTL. FIN. REV., Dec. 2, 2000, at 21. To most Europeans, “compensation” means indemnities for injury or damages. They use the word “remuneration” when

imperative" is at work<sup>3</sup> that can be alternatively dubbed "the Americanization of international pay practices."<sup>4</sup> "As markets become truly global, you'll see the differences in compensation shrink," the managing director of one executive search firm has predicted.<sup>5</sup> Or, as a leading U.S. expert on managerial remuneration has been quoted as saying, "the rest of the world is moving to our pay model."<sup>6</sup>

Not all agree that a "global shakeup in executive comp"<sup>7</sup> is taking place along American lines. Various observers believe that the divergence between the United States and other countries will persist and may even widen.<sup>8</sup> For instance, the author of a well-known book on executive pay has suggested that "[t]he notion of closing the gap is laughable. . . . When you're 200 laps behind and driving a supercharged Audi, how do you catch up with an American car with 5,000 horsepower?"<sup>9</sup>

Despite the controversy over the potential globalization of executive pay, the issue has attracted relatively little attention in legal circles.<sup>10</sup> This Article addresses the gap in the literature by examining the factors likely to affect convergence on the managerial remuneration front. After surveying the essential elements of managerial compensation in the United States and elsewhere, the Article canvasses market-oriented dynamics that could constitute a "global compensation imperative." Still, while market forces will undoubtedly influence international trends in executive pay to some degree, it is difficult to predict whether they will act as decisive agents of change. This is because, as the Article discusses, legal regulation and business "culture" may hinder

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referring to all the elements for rewarding work. See Gary Parker, *Establishing Remuneration Practices Across Culturally Diverse Environments*, COMPENSATION & BENEFITS MGMT., Apr. 1, 2001, at 23, available at 2001 WL 7675825. These terms will be used interchangeably here.

3. Matthew E. Davis, *Fast Forward: The Global Compensation Imperative*, ACA NEWS, May 2000, at 22.

4. Tom Leander, *The Global Shakeup in Executive Comp*, 12 GLOBAL FIN. No. 8, 1, 1. See *infra* notes 73 to 115 and related discussion for further background, as well as Francis Cairncross, *The Best . . . and the Rest (A Survey of Pay)*, ECONOMIST, May 8, 1999, at 13-14. Equating globalization with Americanization is, of course, not a practice restricted to executive pay. See, e.g., James Cox, *US Success Draws Envy, Protests*, USA TODAY, Aug. 3, 2000, at B1.

5. Julia Flynn, *Managing Change: Pay for U.K. CEOs Trails US; Global Consolidation Could Bring Change*, WALL ST. J. (Europe), June 6, 2000, at 28.

6. David Cay Johnston, *American-Style Pay Moves Abroad: Importance of Stock Options Expands in a Global Economy*, N.Y. TIMES, Sept. 3, 1998, at C1 (quoting Professor Kevin J. Murphy).

7. Leander, *supra* note 4.

8. Stephen Gates, *Aligning Performance Measures and Incentives in European Companies*, 9 ACA. J. 3, 19 (2000), available at 2000 WL 15531300 (quoting a Scandinavian management consultant); Susan J. Stabile, *My Executive Makes More than Your Executive: Rationalizing Executive Pay in a Global Economy*, 14 N.Y. INT'L L. REV. 63, 80-86 (2001); Cf. Cath Blackledge, *Euroland Bonanza*, EUROPEAN, June 8, 1998, at 20 (quoting Professor Leo Murray, director of the Cranfield School of Management).

9. Adam Bryant, *American Pay Rattles Foreign Partners*, N.Y. TIMES, Jan. 17, 1999, § 4, at 1 (quoting Graef Crystal, author of *IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES* (W.W. Norton, 1991)).

10. See Brian R. Cheffins, *The Metamorphosis of 'Germany Inc.': The Case of Executive Pay*, 49 AM. J. COMP. L. 497 (2001) [hereinafter Cheffins, *Metamorphosis*]; but see Stabile, *supra* note 8.

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convergence sufficiently to vindicate a claim made by two compensation consultants in 1999: “Global Pay? Maybe Not Yet!”<sup>11</sup>

The U.S. pay paradigm has sparked controversy at home.<sup>12</sup> Not surprisingly, then, a potential shift towards U.S.-style compensation arrangements has proved contentious in other jurisdictions.<sup>13</sup> This Article does not assess in detail whether convergence along American lines would be a “good thing.” Instead, its primary purpose is to identify and analyze the variables that will determine whether such a shift is likely to take place.<sup>14</sup> This does not mean, however, that the Article is purely descriptive. The authors recognize that lucrative U.S. pay packages could either align the interests of shareholders and executives or instead enable self-serving managerial “rent extraction.”<sup>15</sup> Also, the Article makes a significant normative contribution by identifying obstacles regulators ought to address if they are seeking either to promote or hinder a shift towards the lucrative, incentive-based model of executive pay that prevails in the United States.

The Article is organized as follows: Part II gives an overview of the “U.S. pay paradigm,” emphasizing the special position of American chief executives; Part III discusses arrangements in other countries; Part IV offers an analysis of market factors that might promote convergence of executive pay practices along American lines; Parts V and VI consider the impact which legal regulation might have on any sort of globalization trend; and Parts VII and VIII examine the potential effects of “soft law” and “culture.” A brief series of normative observations forms the Article’s conclusion.

### II. THE U.S. PAY PARADIGM

When assessing the characteristics of executive pay in the United States, it is important to recognize the distinctive position of American chief executives. On the compensation front, American chief executive officers (CEOs) are “a breed apart.”<sup>16</sup> This pivotal attribute of the U.S. pay paradigm manifests itself chiefly

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11. Steven E. Gross & Per L. Wingerup, *Global Pay? Maybe Not Yet*, COMPENSATION & BENEFITS REV., July 1, 1999, at 25, 33-34, available at 1999 WL 12755622.

12. See, e.g., Kevin J. Murphy, *Executive Compensation*, in Orley Ashenfelter & David Card eds., HANDBOOK OF LABOR ECONOMICS 2485, 2551-55 (Elsevier, 1999); *CEO Pay: Is Greed Good?*, BUS. WK., Apr. 19, 1999, at 186.

13. See, e.g., Alan Mitchell, *Grande Bouffe in the Executive Suite*, AUSTL. FIN. REV., Dec. 15, 1999, at 19; *Damn Yankees*, FORBES, May 17, 1999, at 206; Johnston, *supra* note 6; Sean Silcoff, *Corporate Elite Takes Home a 43% Pay Rise*, NAT’L POST, May 22, 2001, at C01, available at 2001 WL 20484352.

14. One of the authors has explicitly addressed the pros and cons of the U.S. executive pay model in another paper: Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171 (2004).

15. See *infra* notes 122-139 and accompanying text. The “rent extraction” terminology is borrowed from Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751 (2002).

16. Amanda Bennett, *Managers’ Incomes Aren’t Worlds Apart*, WALL ST. J., Oct. 12, 1992, at B1.

in three ways. First, American chief executives have highly “incentivized” pay arrangements. Second, relative to rank-and-file workers, their remuneration is very lucrative. Third, even compared to other senior managers within their own companies, American CEOs are remarkably well paid. These aspects of U.S. executive compensation will now be reviewed in turn.

### A. Highly “Incentivized” Pay

For a rank-and-file American employee, pay is typically fixed at a prescribed hourly, monthly, or annual level, irrespective of contingencies such as firm performance. By contrast, the compensation packages of American chief executives tend to have a substantial variable component, in that entitlement depends on the satisfaction of prescribed conditions.<sup>17</sup> Admittedly, doubts exist as to whether the targets set are sufficiently robust to ensure that CEOs will suffer meaningful penalties when corporate performance is sub-optimal and whether CEOs will be precluded from reaping a windfall simply because there has been a general rise in stock prices.<sup>18</sup> Nevertheless, data compiled by economists Martin Conyon and Kevin Murphy for a study of executive compensation in the United States and Britain reveal that “incentivized” remuneration is clearly important for American CEOs.

Conyon and Murphy surveyed pay arrangements in over 1600 publicly traded American corporations and found that, as of 1997, the typical U.S. CEO received 29% of overall annual compensation in the form of base salary and 63% by way of variable remuneration.<sup>19</sup> Stock option grants, which give managers the right to buy equity from their company at a prescribed “strike” or “exercise” price, were by far the most important type of incentive pay (42% of total compensation).<sup>20</sup> Next in line, at 17% of total compensation, was the annual bonus, typically a cash payment awarded when a company has met specified yearly targets based on criteria such as share price or accounting earnings.<sup>21</sup> Finally, Conyon and Murphy dealt with the long-term incentive plan

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17. BRIAN R. CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE AND OPERATION* 113 (Clarendon Press, 1997); JOSEPH J. MARTOCCHIO, *STRATEGIC COMPENSATION: A HUMAN RESOURCE MANAGEMENT APPROACH* 5, 93 (Prentice Hall, 2004).

18. See, e.g., Bebchuk et al., *supra* note 15, at 801-2, 815-17.

19. Martin J. Conyon & Kevin J. Murphy, *The Prince and the Pauper? CEO Pay in the United States and the United Kingdom*, 110 *ECON. J.* 640, 646-47 (2000).

20. *Id.* For more recent figures suggesting that stock options may be more important than Conyon and Murphy’s study indicates, see Michael Casey, *Stock Options Didn’t Work; What Will?*, *WALL ST. J.*, Aug. 26, 2002, at A2 (indicating that options constituted approximately 69% of the compensation of CEOs in top U.S. companies).

21. Conyon & Murphy, *supra* note 19, at 646. For an article discussing the nature of annual bonus plans, see Peter Chingos, *Annual Incentive Plans for Management*, in Lance A. Berger & Dorothy R. Berger eds., *THE COMPENSATION HANDBOOK: A STATE-OF-THE-ART GUIDE TO COMPENSATION STRATEGY AND DESIGN*, 349, 352-55 (McGraw-Hill, 2000) [hereinafter *COMPENSATION HANDBOOK*].

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(LTIP), a bonus scheme that operates over several years rather than annually.<sup>22</sup> According to their data, LTIPs composed 4% of the compensation of a typical CEO of a publicly traded company.<sup>23</sup>

As data compiled by economists Brian Hall and Jeffery Liebman reveal, the popularity of stock options as a form of CEO compensation is a relatively recent phenomenon.<sup>24</sup> According to their figures, in 1980, the average value of an American chief executive's salary and annual bonus was \$655,000 in real 1994 dollars, and the average value of stock option grants was \$155,000. As of 1994, the salary and bonus had risen 97% to \$1,293,000. In contrast, the average value of stock option grants grew by 683%, to \$1,213,000. Over the same period, the fraction of CEOs receiving stock option awards increased from 30% to nearly 70%. Stock options continued to grow in importance throughout the remainder of the 1990s.<sup>25</sup>

The end of the bull market in 2000 and consequent demands for greater managerial accountability resulting in enactment of the Sarbanes-Oxley Act of 2002<sup>26</sup> led to speculation that U.S. corporations would cut back on the granting of stock options.<sup>27</sup> Massive grants of stock options have indeed become less frequent over the past few years.<sup>28</sup> Still, the vast majority of companies continue to use this form of executive remuneration.<sup>29</sup> Moreover, the total value of long-term incentive compensation awarded to top managers has remained largely constant, as various companies have begun to substitute other forms of performance-oriented remuneration for stock options.<sup>30</sup> For instance, restricted stock, which cannot be sold until the recipient serves at the company for a specified period of time, is emerging as one popular alternative.<sup>31</sup>

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22. Instead of cash, LTIPs often award executives with either "restricted stock" (equity that cannot be sold for a specified number of years) or "units" under a performance scheme that allows them to receive financial benefits akin to owning equity without actually giving them shares (e.g. "phantom stock" or "stock appreciation rights"). See Jeffrey S. Hyman, *Long-Term Incentives*, in COMPENSATION HANDBOOK, *supra* note 21, at 357.

23. Conyon & Murphy, *supra* note 19, at F646-48.

24. Brian J. Hall & Jeffrey B. Liebman, *Are CEOs Really Paid Like Bureaucrats?*, 113 Q.J. ECON. 653, 661-63 (1998); see also Ernie Englander & Allen Kaufman, Executive Compensation, Political Economy, and Managerial Control: The Transformation of Managerial Incentives and Ideology, 1950-2000, 16-17, SMPP Working Paper 03-01, George Washington University School of Business (January 2003) ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=408820](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=408820)).

25. Englander & Kaufman, *supra* note 24, at 17; Ruth Simon & Ianthe Jeanne Dugan, *Options Overdose*, WALL ST. J., June 4, 2001, at C1.

26. Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15, 28, and 29 U.S.C.).

27. Henry Morgenbesser et al., *Do Stock Options Have a Future in America?*, INT'L FIN. L. REV., Sept. 2002, at 15; Nanette Byrnes, *Beyond Options*, BUS. WK., July 28, 2003, at 34.

28. Patrick McGeehan, *A Remix in the Grants of Options and Stock*, N.Y. TIMES, April 6, 2003, § 3, at 4.

29. *Id.*

30. *Gains in Executive Compensation Moderating*, TOWERS PERRIN MONITOR, May 2003, available at <http://www.towers.com/towers/> (reporting on a survey of seventy-five major companies indicating that long-term incentive pay for CEOs was \$3,350,000 in 2002 proxy statements and \$3,340,000 in 2003).

31. Joann S. Lublin, *With Options Tainted, Companies Award Restricted Stock*, WALL ST. J., Mar. 3,



### B. Lucrative Compensation

In addition to providing historical perspective on the use of stock options, the Hall and Liebman data demonstrate that CEO pay in the United States is highly lucrative. More recent figures from other sources drive home the same point. For instance, according to a 2001 study of worldwide executive pay by remuneration consultants Towers Perrin (which used as a benchmark an industrial company with approximately \$500 million in annual sales), total annual remuneration for a U.S. chief executive averaged \$1,933,000.<sup>32</sup> Compensation levels are even higher at large companies. According to a survey of 2002 data by *Business Week*, the median total compensation for the 365 most highly paid chief executives in the United States was \$3.7 million, and average pay was \$7.4 million.<sup>33</sup>

A highly publicized by-product of the lucrative compensation packages received by American chief executives is a dramatic disparity between their pay and that of rank-and-file workers.<sup>34</sup> Figures compiled by Hall and Liebman illustrate that the divergence became particularly pronounced during the 1980s and 1990s.<sup>35</sup> In 1982, the direct compensation of the average CEO (salary and bonus plus the value of stock option grants) was thirty times greater than the pay of the typical employee. Between 1982 and 1994, the average CEO's direct compensation increased 175%, or approximately 8.8% annually. During the same time period, the typical employee's pay grew 7.2%, or 0.6% annually. As a result, by 1996, CEO direct compensation was 210 times that received by an average employee.<sup>36</sup> This disparity grew substantially through 2001, when dramatic growth in executive pay shuddered to a halt.<sup>37</sup>

### C. CEOs are Paid More Than Other Senior Managers

Unlike the highly publicized comparisons between CEOs and rank-and-file

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2003, at B1; Howard Stock, *CEO Bonuses Grow, Despite Mostly Disappointing Returns*, INVESTOR REL. BUS., June 9, 2003, available at 2003 WL 9295256; Paula Todd, *Preparing for What's to Come in Executive Compensation*, TOWERS PERRIN MONITOR, July 2003, available at <http://www.towersperrin.com>.

32. TOWERS PERRIN, WORLDWIDE TOTAL REMUNERATION 20 (2001).

33. Louis Lavelle, *Special Report: Executive Pay*, BUS. WK, April 21, 2003, at 86 (discussing results of *Business Week's* 53<sup>rd</sup> Annual Pay Scoreboard).

34. See, e.g., Don Bauder, *Skewed Distribution of Wealth Has Us on Perilous Path*, SAN DIEGO UNION-TRIB., July 22, 2001, at H2; James Flanigan, *Wanted: Executives Worthy of Respect*, L.A. TIMES, May 4, 2003, at C1; Geneva Overholser, *More on the Inflated Pay of Business Titans*, INT'L HERALD TRIB., Nov. 5, 1999, at 9.

35. Hall & Liebman, *supra* note 24, at 661-67. For figures confirming the same historical pattern, see Richard Donkin, *Leap in US CEO Pay*, FIN. TIMES, Sept. 16, 1998, at 36.

36. Randall S. Thomas, *Should Directors Reduce Executive Pay?*, 54 HASTINGS L.J. 437, 440 (2003).

37. Sarah Anderson et al., *Executive Excess 2002: CEO's Cook the Books, Skewer the Rest of Us* 14-16 (2002), available at <http://www.faireconomy.org/press/2002/EE2002.pdf>.

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employees, relatively little has been said about the compensation disparity between U.S. chief executives and other senior managers.<sup>38</sup> Nevertheless, the available evidence indicates that the divergence is significant. For instance, according to the same Towers Perrin survey that pegged annual CEO pay at \$1,933,000, the total compensation of U.S. CEOs was 4.3 times greater than that of human resources directors in equivalent companies.<sup>39</sup> Furthermore, a study using 2000 data found that CEOs of large manufacturing companies earned \$1.82 in total compensation for every \$1 earned by the second-highest paid executive, and \$3.44 for every \$1 earned by the fifth-highest paid executive.<sup>40</sup>

In addition to receiving substantially better pay than other top managers, U.S. chief executives tend to have more “incentivized” pay arrangements. According to 2001 data from Towers Perrin, the ratio of long-term incentives (defined to encompass stock options, stock grants, and similar awards) to salary was 1.61 to 1 for a typical American chief executive, but only .66 to 1 for a typical human resource director.<sup>41</sup> A study using 2000 data showed a similar pattern, with CEOs in large American manufacturing firms receiving, on average, stock option grants worth 636% of salary, while the equivalent figure for the other top four executives was only 390%.<sup>42</sup> A by-product of this pattern is that, according to figures compiled in the mid-1990s, the average pay-performance sensitivity for a chief executive of an American public company was \$41.22 per thousand dollar increase in shareholder wealth and the equivalent figure for executives with divisional responsibilities was only \$3.68.<sup>43</sup>

### III. EXECUTIVE PAY IN THE REST OF THE WORLD

American CEOs are not merely a “breed apart” within their own country. Rather, their remuneration arrangements are also distinctive by international standards. As this Part discusses, companies located outside of the United States place less emphasis on performance-oriented pay and award less lucrative managerial compensation packages than do their American counterparts. Still,

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38. Harley E. Ryan & Roy A. Wiggins, *Differences in the Compensation Structures of the CEO and Other Senior Managers*, 6 J. BUS. & ECON. STUD. 22, 22-23 (2000); Rajesh K. Aggarwal & Andrew A. Samwick, *Performance Incentives Within Firms: The Effect of Managerial Responsibility*, 58 J. FIN. 1613, 1614, 1637-38 (2003). For a discussion as to why this might be the case, see PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION AND MANAGEMENT* 427 (Prentice Hall, 1992).

39. TOWERS PERRIN, *supra* note 32, at 20-21.

40. Derived from Englander & Kaufman, *supra* note 24, at 32 (setting out data initially compiled by the Conference Board).

41. TOWERS PERRIN, *supra* note 32, at 26-27. On the definition of long-term incentives for the purposes of the Towers Perrin study, see *id.* at 3.

42. Englander & Kaufman, *supra* note 24, at 17, 31.

43. Aggarwal & Samwick, *supra* note 38, at 1636-38. Of the amounts in question, \$40.26 could be attributed to stock and options in the case of CEOs, and the equivalent figure for divisional executives was \$3.47.

there is some evidence of a shift towards U.S. compensation patterns.

*A. Less Emphasis on Performance-Oriented Pay than in the United States*

In the United States, variable pay is a much more important component of CEO remuneration than is the case elsewhere. The award of annual bonuses contributes partially, though not crucially, to this divergence. For instance, the Towers Perrin survey cited earlier indicates that in an American industrial company with annual sales of \$500 million, the CEO's annual bonus is likely to be 56% of salary.<sup>44</sup> Comparatively speaking, this is a high figure, though not outstandingly so. Indeed, in two jurisdictions (Australia and Venezuela), the annual bonus to salary ratio was actually higher than this, and in many of the other countries, the equivalent figure was at least half.<sup>45</sup> On the other hand, American companies really stand out when it comes to long-term incentive schemes. As of 2001, according to Towers Perrin, this form of compensation constituted 161% of salary for a typical American chief executive.<sup>46</sup> Only Canada was close to this figure at 90%, and the top European country, Britain, lagged far behind at 44%.

Regarding executives other than CEOs, incentive-oriented pay is again a key cause of disparities between the United States and elsewhere. As is the case with chief executives, arrangements designed to operate over the long haul are the pivotal consideration. According to Towers Perrin figures from 2001, the annual bonus to salary ratio of an average American human resource director in an industrial company with annual sales of \$500 million broadly corresponded to the figures in other countries.<sup>47</sup> Matters were different, however, with respect to variable pay geared to long-term incentives. According to the Towers Perrin data, this type of compensation amounted to 66% of base salary for the average American human resource director.<sup>48</sup> In only two out of the twenty-five jurisdictions surveyed (Malaysia and Singapore) was the long-term incentive to base salary ratio even half of what it was in the United States. Thus, the bias in favor of incentive-oriented pay which exists for CEOs of American companies

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44. *Id.* at 26.

45. It should be borne in mind, however, that the Towers Perrin data may conceal some important cross-border differences concerning the use of annual bonuses. Conyon and Murphy's study of executive compensation in the United States and Britain indicates this. Conyon and Murphy discovered that the annual bonus constituted much the same percentage of total compensation in the two countries and that the percentage of CEOs receiving bonuses was roughly the same in the two countries. Nevertheless, they found that when bonuses were awarded, the payments in the United States were on average triple those granted in Britain. See Conyon & Murphy, *supra* note 19, at nn.647-48.

46. TOWERS PERRIN, *supra* note 32, at 26.

47. *Id.* at 27. The annual bonus of an American human resource director amounted to 29% of salary. Annual bonuses were awarded to human resource directors in all of the twenty-five other jurisdictions Towers Perrin surveyed, and in thirteen of these, the average annual bonus constituted 20% or more of annual basic compensation.

48. *Id.* at 25.

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is also present with other U.S. senior managers, albeit on a lesser scale.

### *B. Executive Pay is Lower Outside the United States*

In addition to receiving remuneration packages with a stronger bias in favor of variable compensation, U.S. CEOs are much better paid overall than their counterparts in other countries. According to the Towers Perrin data cited earlier, total annual pay for a typical U.S. chief executive was \$1,933,000.<sup>49</sup> This amount was more than double the average for CEOs in all of the other twenty-five countries surveyed, and was more than triple the average in all but six (Argentina, Brazil, Canada, China/Hong Kong, Mexico, Singapore, and the United Kingdom).<sup>50</sup>

With lower CEO compensation being the norm outside the United States, foreign companies exhibit a less dramatic pay gulf between chief executives and rank-and-file workers than their American counterparts. Admittedly, in some comparatively poor countries such as Venezuela and Brazil,<sup>51</sup> chief executive compensation is a greater multiple of average employee pay than in the United States. Still, in comparison with leading industrial nations, the United States stands alone. According to data from 1999, while a U.S. CEO earned thirty-four times the average factory wage, the comparable figure was twenty-four in Britain, thirteen in Germany, and eleven in Japan.<sup>52</sup> Moreover, these numbers may underestimate the disparity in the United States, as some data suggest that the ratio is at least seventy-seven to one in larger companies.<sup>53</sup>

What makes CEO pay in the United States so much higher than elsewhere? Salary differentials play a role, but not a major one. The Towers Perrin survey cited earlier pegged the annual salary of an average U.S. CEO at approximately \$540,000.<sup>54</sup> While this was the highest figure among the twenty-six jurisdictions covered, CEOs in Argentina and Mexico both received base pay that exceeded \$400,000 annually and chief executives in eleven other countries had salaries of \$250,000 or more.<sup>55</sup>

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49. *See id.*

50. TOWERS PERRIN, *supra* note 32, at 20.

51. Tony Jackson, *The Fat Cats Keep Getting Fatter*, FIN. TIMES, Aug. 1, 1998, at 9.

52. Robert Taylor, *Facts to Confound the Gurus*, FIN. TIMES, Sept. 7, 2000, at 16; *see also* John M. Abowd & David S. Kaplan, *Executive Compensation: Six Questions That Need Answering*, 13 J. ECON. PERSP. 145, 160-61 (1999); Donkin, *supra* note 35 (setting out statistics that reveal much the same pattern).

53. *See* Hall & Liebman, *supra* note 24, at 661-67. The primary source of inconsistency is the amount that CEOs earn in the United States. The figure cited in the Taylor study, *supra* note 52, was \$1,351,000, whereas in the Hall and Liebman study, *supra* note 24, mean CEO compensation was \$2,506,000 for 1994.

54. TOWERS PERRIN, *supra* note 32, at 20, 24.

55. *Id.* The Towers Perrin figures for Argentina likely do not capture the full effect of downward pressure on CEO salaries caused by a bitter recession in that country. For background, *see* Tony Smith, *Shrinking Salaries Hit Home in Argentina*, N.Y. TIMES, Apr. 6, 2003, § 3, at 6.

What about fringe benefits (“perks”)? Do they contribute significantly to the international gap in CEO pay? While the perks that larger American companies make available to retiring CEOs have recently generated controversy,<sup>56</sup> the answer is no. According to Towers Perrin’s 2001 survey on international executive pay, fringe benefits are not exceptionally generous in the United States.<sup>57</sup> The Towers Perrin data indicate that benefits such as company contributions to retirement and insurance plans and perquisites such as company cars and club memberships constituted 11% of the total compensation of an average U.S. CEO. The equivalent percentage was higher in twenty of the twenty-six countries dealt with in the study.<sup>58</sup>

What, then, separates U.S. CEOs from their counterparts in other countries? The answer is that long-term incentive schemes, such as stock option packages and LTIPs, are primarily responsible for the disparities between the United States and elsewhere. Annual bonuses for American CEOs are quite generous by world standards, but not inordinately so.<sup>59</sup> On the other hand, the long-term incentive remuneration to base salary ratio is considerably higher in the United States than elsewhere.<sup>60</sup> Since the salaries of American CEOs are already the highest in the world, the end result is that U.S. companies award total compensation that well exceeds that granted in other countries. According to the Towers Perrin survey on international executive pay, a typical U.S. chief executive officer received approximately \$870,000 annually in the form of long-term incentive compensation.<sup>61</sup> In only two of the other twenty-five jurisdictions studied did *aggregate* annual CEO compensation match this figure (Argentina at \$879,000 and Mexico at \$867,000).<sup>62</sup>

It is helpful to put the raw data in context. The current pattern in CEO remuneration worldwide is consistent with historical trends. Survey evidence from the early 1960s onwards indicates that American chief executives have consistently been paid more than their foreign counterparts.<sup>63</sup> As the 1990s

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56. David Leonhardt and Geraldine Fabrikant, *Many Chiefs are Retaining Extra Benefits in Retirement*, N.Y. TIMES, Sept. 11, 2002, at C1; Carol Hymowitz, *Inactive Chiefs No Longer Need to be Pampered*, WALL ST. J., Sept. 13, 2002, at B1.

57. Moreover, amid accounting and fraud scandals, various large U.S. companies have begun to cut back on the perks they do offer to top corporate officials. Lynnley Browning, *The Perks Still Flow (But With Less Fizz)*, N.Y. TIMES, Apr. 6, 2003, § 3, at 6.

58. TOWERS PERRIN, *supra* note 32, at 24. On how the terms were defined for the purposes of the study, see *id.* at 3. See Shawn Tully, *American Bosses are Overpaid. . .or Their Counterparts in Europe are Underpaid*, FORTUNE, Nov. 7, 1988, at 121; Abowd & Kaplan, *supra* note 52, at 146, Table 1 (according to 1996 data, out of twelve industrialized countries, the total value of fringe benefits offered by U.S. corporations to CEOs only ranked fifth).

59. See TOWERS PERRIN, *supra* note 32.

60. *Id.*

61. *Id.* at 20, 24, 26.

62. *Id.* at 20.

63. Abowd & Kaplan, *supra* note 52, at 146, Table 1 (setting out data for 1984 and 1996); Arch Paton, *Executive Compensation Here and Abroad*, HARV. BUS. REV., Sept.-Oct. 1962, at 144, 152 (citing data from McKinsey & Co.); Detlev Vagts, *Challenges to Executive Compensation: For the Markets or*

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began, there was some speculation that the gap between the United States and elsewhere was closing.<sup>64</sup> By the middle of the decade, however, any such narrowing had stalled as dramatic increases in long-term incentive compensation caused American executive pay to rise to unprecedented levels.<sup>65</sup>

Also noteworthy is that U.S. CEOs do not seem to sacrifice job security for higher pay. Though some have suggested that chief executives outside the United States do not face the same external scrutiny as their American counterparts,<sup>66</sup> the reality appears to be different. Data from the 1980s indicate that CEOs in Japan and Germany were, if anything, *more* likely to be dismissed than American chief executives when a company suffered a major share price decline or a drop in earnings.<sup>67</sup> More recently, a 2000 study carried out by management consultants Drake Beam Morin revealed that CEO turnover rates are equally high world-wide.<sup>68</sup> Moreover, according to data from 2002, CEO tenure was shorter in Europe than in North America, and the dismissal rate for sub-standard performance was roughly equivalent.<sup>69</sup>

A final point to keep in mind when thinking about the disparity between CEO pay levels in the United States and elsewhere is that the situation is not nearly as exceptional with lower-ranking executives. As mentioned, a notable, if little remarked upon feature of the U.S. pay paradigm is that CEOs are much better paid than other senior managers.<sup>70</sup> The discrepancy is not as substantial elsewhere. Again, according to the 2001 Towers Perrin survey on international managerial remuneration, the ratio of chief executive to human resource director pay was 4.3 to 1 in the United States.<sup>71</sup> This was considerably greater than the equivalent figure in other major industrial economies, such as France (2.4 to 1), Germany (2.0 to 1), Japan (2.4 to 1), and Britain (2.2 to 1).<sup>72</sup>

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*the Courts?*, 8 J. CORP. L. 231, 252 (1983). An exception to the pattern is *International Executive Compensation*, WHARTON MAG., Winter 1978, at 59, but this survey only dealt with base salaries.

64. See, e.g., John Burgess, *Big Bucks for Executives Finds Some Favour Abroad*, WASH. POST, Oct. 20, 1991, at H1; Joann S. Lublin, *The Continental Divide: The Gap Between Executive Pay in the U.S. and in Europe Is Narrowing, but It May Never Close*, WALL ST. J., Apr. 18, 1990, at R28.

65. Tara Parker-Pope, *So Far Away*, WALL ST. J., Apr. 11, 1996, at R12.

66. Katherine Gay, *Canadian Pay Hampers CEO Talent Hunt*, FIN. POST, Apr. 22, 1995, at 57; Richard Morais et al., *The Global Boss' Pay: Where (and How) the Money Is*, FORBES, June 7, 1993, at 90; Paul G. Wilhelm, *Application of Distributive Justice Theory to the CEO Pay Problem: Recommendations for Reform*, 12 J. BUS. ETHICS 469, 474 (1993).

67. Steven N. Kaplan, *Corporate Governance and Corporate Performance: A Comparison of Germany, Japan and the US*, 9(4) J. APPLIED CORP. FIN. 86, 88-89 (1997).

68. Sam Marshall, *The Disposable CEO*, ASIAN WALL ST. J., July 14, 2000, at 1 (discussing CEO turnover and job security as presented in a study by Drake Beam Morin, *CEO Turnover and Job Security: A Special Report* (2000)) (unpublished manuscript, on file with authors).

69. Chuck Lucier et al., *Deliver or Depart*, STRATEGY + BUS., Summer 2003, Special Report, at 1, 6, 12, available at <http://www.strategybusiness.com/press/article/21261?pg=0>.

70. See TOWERS PERRIN, *supra* note 32.

71. *Id.*

72. Derived from data set out in TOWERS PERRIN, *supra* note 32, at 20-21. The contemporary pattern constitutes something of a reversal of historical trends. According to data from the early 1960s, the divergence between CEO compensation and the compensation made available to other top executives

*C. Evidence of Convergence*

Since performance-related remuneration (especially stock options and other incentivized pay with a long-term orientation) serves to distinguish executive pay in the United States from that in other countries,<sup>73</sup> an internationally oriented shift towards performance-based compensation would constitute a significant convergence trend. There is some evidence to suggest that such a pattern is in fact developing. First of all, annual bonuses appear to be an increasingly important element of overall compensation worldwide. The Towers Perrin survey of worldwide executive remuneration for 2001 indicates that in eighteen of the twenty-six jurisdictions covered, the annual bonus to salary ratio was higher for CEOs than it was in 1996.<sup>74</sup> For human resource directors, the outcome was similar in twenty-one countries.<sup>75</sup>

The same pattern is evident with long-term incentive compensation. According to the Towers Perrin data, in 1996 there were fourteen jurisdictions where chief executives did not participate in a long-term incentive scheme and twenty where the human resource director did not do so. By 2001, these figures had dropped to four for both CEOs and human resource directors.<sup>76</sup> Moreover, in those countries where long-term incentive plans were in place in 1996 and 2001 for both CEOs and human resource directors, the long-term incentive scheme to base salary ratio increased in every country but one (Switzerland).<sup>77</sup>

Additional research from a Towers Perrin 2001 report on stock options confirms that incentivized pay based on long-term targets is becoming increasingly common outside the United States. According to the study, which examined the practices of large, local companies headquartered in twenty-two different countries, such compensation prevailed in only a handful of jurisdictions in 1997.<sup>78</sup> The study predicts, however, that soon it will be the norm for executives to participate in long-term incentive schemes.<sup>79</sup> Moreover, consistent with the U.S. pattern, stock option plans are emerging as the most popular type of performance-oriented compensation.<sup>80</sup>

Anecdotal evidence confirms the trends identified by the Towers Perrin report. Traditionally, the American practice of granting stock options has not been followed elsewhere.<sup>81</sup> In Britain, for instance, share option plans were

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was greater outside the United States than it was in American firms. See Paton, *supra* note 63, at 152 (citing data from McKinsey & Co.).

73. See *supra* notes 17-31 and accompanying text.

74. TOWERS PERRIN, *supra* note 32, at 26.

75. *Id.* at 27.

76. *Id.* at 26-27.

77. *Id.*

78. TOWERS PERRIN, STOCK OPTIONS AROUND THE WORLD 4 (2001).

79. *Id.*

80. *Id.* at 5.

81. Shirley Fung, *How Should We Pay Them?*, ACROSS THE BOARD, June 1999, at 36, 37-38; Luisa

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largely unknown until the mid-1980s, when large numbers of companies began to change their approach.<sup>82</sup> Stock options began to gain ground in some other European countries during this same period,<sup>83</sup> but they remained of negligible importance in Germany and Italy.<sup>84</sup> Likewise, long-term incentive compensation of any sort was virtually unknown in countries such as Belgium, the Netherlands, Sweden, and Spain.<sup>85</sup>

Matters have been changing in Europe during the past few years, however. By the late 1990s, growing numbers of European executives were reportedly receiving part of their pay in stock options or LTIPs.<sup>86</sup> The trend towards performance-oriented compensation attracted attention in the business press, eliciting headlines such as “Euroland Bonanza”<sup>87</sup> and “A Yawning Gap Begins to Close.”<sup>88</sup> Indeed, by 2001, most of Europe’s large publicly traded companies had adopted share option programs.<sup>89</sup>

The experience has been similar in several countries in other regions. Until recently, stock option plans were virtually unknown in Japan.<sup>90</sup> Now, a growing number of Japanese companies are creating such schemes for senior employees.<sup>91</sup> Similarly, in Australia, stock option plans were not widely adopted

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Kroll, *Catching Up*, FORBES, May 19, 1997, at 162. C.W. Smith & R.L. Watts, *Incentive and Tax Effects of Executive Compensation Plans*, in R. Ball & C.W. Smith eds., THE ECONOMICS OF ACCOUNTING POLICY CHOICE 347, 359 (McGraw-Hill, 1992) (originally published in 7 AUSTL. J. MGMT. 139 (1982)) (discussing the popularity of stock options in the United States since the 1950s).

82. Helen Kay, *Have We Killed the Share Option?*, DIRECTOR, Oct. 1995, at 64, 66; Laura Mazur, *Europay*, ACROSS THE BOARD, Jan. 1995, at 40; *Executive Pay; Perky*, ECONOMIST (UK ed.), Oct. 8, 1988, at 48 (referring to share options as “the newest executive game”).

83. Alain Alcouffe & Christiane Alcouffe, *Control and Executive Compensation in Large French Companies*, 24 J.L. & SOC’Y 85, 96 (1997); Lublin, *supra* note 64 (mentioning Austria, Denmark and Norway). The evidence concerning France is, however, conflicting. See, e.g., Charles Peck et al., *Top Executive Compensation: Canada, France, the United Kingdom, and the United States*, in THE CONFERENCE BOARD, RESEARCH REPORT 1250-99-RR, 1999, at 19-21; Mazur, *supra* note 82.

84. Stefan Prigge, *A Survey of German Corporate Governance*, in Klaus J. Hopt et al. eds., COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 943, 967 (Clarendon Press, 1998); Mazur, *supra* note 82; Andrea Melis, *Corporate Governance in Italy*, 8 CORP. GOVERNANCE: INT’L REV. 347, 353 (2000).

85. Abowd & Kaplan, *supra* note 52, at 146. For more detail on Spain see Charlotte Villiers et al., *Controlling Directors’ Pay in English Law and Spanish Law*, 2 MAASTRICHT J. EUR. & COMP. L. 377, 391-92 (1995).

86. *Damn Yankees*, *supra* note 13; Johnston, *supra* note 6.

87. Blackledge, *supra* note 8.

88. Tony Barber, *FT Director Survey*, FIN. TIMES, June 2, 2000, at 5.

89. Guido Ferrarini et al., *Executive Remuneration in the EU: Comparative Law and Practice*, in ECGI Working Paper Series in Law No. 09/2003, at 46-64 (offering data on adoption of share option programs by FTSE Eurotop 300 companies), available at <http://www.ecgi.org/wp/index.php> (last visited Dec. 8, 2004).

90. W. CARL KESTER, *JAPANESE TAKEOVERS: THE GLOBAL CONTEST FOR CORPORATE CONTROL* (Harvard Business School Press, 1991); Steven Brull, *Sony Links Executive Pay to Stocks*, INT’L HERALD TRIB., Aug. 11, 1995, at 11; Michael Berger, *A Look at Salaries in Japan*, S.F. CHRON., May 9, 1988, at B8.

91. Nicholas Benes, *Japan’s Coming Shareholder Revolution*, ASIAN WALL ST. J., Feb. 14, 2001, at 6; Yasmin Ghahremani, *In the Company of Millionaires*, ASIA WK., Mar. 17, 2000, available at 2000 WL 8936312. For further background, see Paul Abrahams, *Japan’s Ray of Hope*, FIN. TIMES, May 6,



prior to 1990,<sup>92</sup> but have since become popular.<sup>93</sup> Canada has experienced the same trend, though most larger public companies did grant some stock options prior to the 1990s.<sup>94</sup>

While long-term incentive compensation is becoming more common as a form of executive pay, it should not be assumed that American-style compensation is now the international norm. It must be remembered that stock options and similar incentive schemes remain much more lucrative in the United States than elsewhere, particularly for CEOs. The Towers Perrin survey cited earlier draws attention to this divergence by indicating that the ratio of long-term incentive compensation to salary remains considerably higher in the United States than in other countries.<sup>95</sup> This study, however, might not do full justice to the disparity. While stock option grants did become firmly established in Britain in the 1980s,<sup>96</sup> as of 1997, among CEOs receiving such compensation, the median option grant in the United States was nearly twenty times that of Britain.<sup>97</sup>

Also significant is that stock options made available to executives in other countries often differ in type and form than those granted domestically. In the United States, most companies award "plain vanilla" share options to executives, meaning that options can be exercised without regard for performance conditions.<sup>98</sup> Therefore, management can be rewarded for any rise in their company's share price, even if the increase was well below that realized by competitors or by the market as a whole.<sup>99</sup> On the other hand, in countries such as Australia, Germany, Italy, the Netherlands, South Africa, and Britain, it is the norm for stock options to be awarded subject to performance conditions.<sup>100</sup> With this sort of arrangement, executives are only able to exercise

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1998, at 19; *Restoration in Progress: A Survey of Business in Japan*, ECONOMIST, Nov. 27, 1999, at 8-9; Lisa Shuchman, *New Tool in Tokyo*, WALL ST. J., Apr. 9, 1998, at R9.

92. Jane Hutchinson, *Turning the Spotlight on the Boss's Pay*, AGE, Apr. 8, 1992, at 19.

93. Jennifer Hill, *Regulatory Rooms in Australian Corporate Law*, 25 BROOK. J. OF INT'L L. 555, 601 (1999); Emily Carr, *Up! Up! Up! CEO Salaries are on the Rise*, AUSTL. FIN. REV., Oct. 3, 1998, at 28; Margot Saville, *Up, Up and... Execs Double Pay in 5 Years*, SYDNEY MORNING HERALD, Nov. 16, 2000, at 29; S. Karene Witcher, *Salaries Surge as Concerns Seek Offshore Talent, Specifically in America*, ASIAN WALL ST. J., July 28, 1998, at 6.

94. *CEO Compensation is Not Soaring*, GLOBE & MAIL, Apr. 26, 1999, at A10; Sean Silcoff, *Corporate Elite Takes Home a 43% Pay Rise*, NAT'L POST, May 22, 2001, at C1; Philip Mathias, *Just How Fat are These Cats?*, FIN. POST, Nov. 4, 1995, at 10; Eric Reguly, *Pay-Performance Link Stretches Thin*, GLOBE & MAIL, Mar. 4, 1999, at B2. On the situation at the beginning of the 1990s, see Bruce Cohen, *Pay: What Top Executives Can Expect*, FIN. POST, July 8, 1991, at 17.

95. See *supra* notes 17-31 and accompanying text.

96. See *supra* note 82 and accompanying text.

97. Conyon & Murphy, *supra* note 19, at F648.

98. Bebhuk et al., *supra* note 15, at 801-2; Alfred Rappaport, *New Thinking on How to Link Executive Pay with Performance*, HARV. BUS. REV., Mar.-Apr. 1999, at 91, 92-93.

99. Bebhuk et al., *supra* note 15, at 796-97; Abowd & Kaplan, *supra* note 52, at 162; Rappaport, *supra* note 98, at 93.

100. TOWERS PERRIN, *supra* note 78, at 7.

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options if the company has met specified “benchmarks” such as exceeding a designated earnings per share target.

With respect to possible convergence on the executive pay front, increased use of performance-related pay implies a shift towards potentially more generous managerial compensation. Why is this the case? The key point to keep in mind is that, for good reason, executives will have reservations about having their pay tied directly to shareholder return.<sup>101</sup> For instance, on diversification grounds, they will dislike having their remuneration linked to the performance of a company in which they have already tied up substantial human capital.<sup>102</sup> Also, since an individual company’s stock price often fluctuates markedly, they will fear significant swings in income. Moreover, they will worry about having their remuneration tied to share prices since factors unrelated to the skill and effort of a company’s top people can influence its market standing.<sup>103</sup>

Despite these various difficulties, companies seeking to recruit and retain good people do have an ability to link managerial remuneration more closely with shareholder return if that is a key priority. The strategy to adopt is straightforward: offer a highly lucrative “upside.” If the potential rewards are large enough, a talented executive will accept the risks of linking remuneration to shareholder return.<sup>104</sup> The upshot is that if foreign companies move towards the U.S. pay paradigm by using more performance-related compensation, there will be pressure to shift towards the sort of lucrative pay that serves to make America’s CEOs a “breed apart.”

The analysis of executive pay convergence offered thus far has focused on other countries moving towards the U.S. model, but a different convergence scenario also merits consideration. Conceivably, recent economic conditions might temper America’s exceptional managerial compensation arrangements and bring matters more in line with other nations. Indeed, declining stock market prices and corporate scandals have undercut faith in “superstar” CEOs, individuals who had formerly been lauded for their significant roles in realizing the American economic expansion of the 1990s.<sup>105</sup> A predicted consequence of this shift in attitude is the reining in of executive pay.<sup>106</sup> Indeed, one U.S.

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101. Cheffins, *supra* note 17, at 686.

102. John E. Core et al., *Executive Equity Compensation and Incentives: A Survey*, FED. REV. BANK N.Y. ECON. POL’Y REV., Apr. 2003, at 27, 36-37 (saying that an executive will discount the value of a grant of stock options because of poor diversification).

103. In companies with concentrated share ownership, there are additional reasons why managers will not value highly compensation that is linked to share price performance. See *infra* notes 117 to 143 and accompanying text.

104. Cheffins, *supra* note 17, at 686-87.

105. Andrew Hill, *The Business Mighty are Now Fallen*, FIN. TIMES (LONDON), May 4, 2002, at 13; Alan Eisner, *The Era of CEO as Superhero Ends Amid Corporate Scandals*, GLOBE & MAIL, July 10, 2002, at C1; David Olive, *How Celebrity CEOs Failed to Deliver*, TORONTO STAR, Aug. 24, 2002, at A01.

106. Robert J. Samuelson, *CEO Welfare*, WASH. POST, Apr. 30, 2003, at A23.

compensation advisor proclaimed “the end of a golden era.”<sup>107</sup>

It is possible that certain interrelated factors could operate simultaneously to downgrade performance-oriented executive pay and to cut remuneration levels for U.S. CEOs. The high-powered incentive plans that delivered spectacular rewards when times were good may yield few benefits for executives when companies are suffering from faltering shareholder returns.<sup>108</sup> Investors disillusioned by mediocre stock prices and corporate scandals may try to exert pressure on companies to curb perceived management excesses.<sup>109</sup> Top executives seeking to boost corporate morale and secure public relations benefits might “share the pain” with employees and shareholders by voluntarily surrendering pay to which they might otherwise be entitled.<sup>110</sup> Finally, “star” managers, nervous that a prolonged economic slump will make it difficult to cash in on incentive-oriented compensation, might begin to use their negotiating leverage to secure deals in which variable pay is featured less prominently.<sup>111</sup>

Indeed, some evidence indicates that the configuration of executive pay in the United States is being overhauled. According to a *Business Week* survey, though the average total compensation of America’s 365 most highly paid executives was \$7.4 million in 2002, this represented a 33% decline from 2001, and the second year in a row in which there had been a decline.<sup>112</sup> Still, it is important to keep matters in perspective: the 2001-2002 drop in average CEO compensation recorded by *Business Week* occurred not on account of wholesale rearrangement of compensation schemes, but rather because massive payments at the very top of the scale largely disappeared. Correspondingly, while average pay for the 365 CEOs decreased by one third between 2001 and 2002, median pay actually increased by 5.9%.<sup>113</sup>

Other surveys of executive remuneration carried out by the business press confirm that, while some downward revisions are occurring, these do not “threaten the underlying nature of the CEO entitlement system.”<sup>114</sup> Hence, despite current economic conditions, the dismantling of the American model of

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107. Joann S. Lublin, *Under the Radar*, WALL ST. J., Apr. 11, 2002, at B7.

108. Joann S. Lublin, *Hedging Their Bets*, WALL ST. J., Apr. 12, 2001, at R1; Janet McFarland, J., *CEO Pay Fails to Mimic Profits*, GLOBE & MAIL, Apr. 23, 2002, at B1.

109. Aaron Lucchetti, *A Mutual Fund Giant is Stalking Excessive Pay*, WALL ST. J., June 12, 2002, at C1; Caroline Daniel and Andrew Hill, *Demands from Shareholders for Greater Transparency and Accountability Over the Rewards Enjoyed by Corporate Leaders are Ringing Out at Annual Meetings Across the US*, FIN. TIMES, May 5, 2003, at 15.

110. Lavelle, *supra* note 33 (discussing the CEO of Agilent Technologies Inc.); Brenda L. Moore, *No, Thanks*, WALL ST. J., Apr. 12, 2001, at R4.

111. Lublin, *supra* note 108; *Under Water*, ECONOMIST, Nov. 10, 2001, at 91; *Is That Enough?*, ECONOMIST, May 3, 2003, at 72.

112. Lavelle, *supra* note 33.

113. *Id.*; see also Jerry Useem, *Have They No Shame?*, FORTUNE, Apr. 28, 2003, at 56.

114. Samuelson, *supra* note 106; on the surveys in question, see also Useem, *supra* note 113; Joann S. Lublin, *Why the Get-Rich-Quick Days may be Over*, WALL ST. J., Apr. 14, 2003, at R1; Patrick McGeehan, *Again, Money Follows the Pinstripes*, N.Y. TIMES, Apr. 6, 2003, sec. 3, at 1.

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executive pay does not appear to be happening.<sup>115</sup> It follows that, to the extent that global convergence is imminent, it remains more likely that corporations in other countries will move towards the American approach rather than the reverse.

### IV. MARKET-ORIENTED DRIVERS OF EXECUTIVE PAY

The foregoing discussion illustrates that companies outside the United States pay their executives (and particularly their CEOs) in a manner that is considerably different from their American counterparts. At the same time, though, the disparity may be diminishing as companies around the world shift, in varying degrees, towards the U.S. pay model.<sup>116</sup> What might be providing the impetus for this convergence trend? Market forces of various types are potentially playing a role. This Part of the Article identifies examples and concludes with some observations on how influential these market dynamics are likely to be in the future.

#### *A. Evolving Share Ownership Patterns*

Share ownership in large U.S. business enterprises is typically widely dispersed. Such diffusion results from the fact that most big companies are publicly traded, and only in a minority of these does a single investor own a substantial block of shares.<sup>117</sup> Britain's corporate economy is configured in a similar fashion.<sup>118</sup> In other major industrial countries, however, concentrated share ownership is the norm. In these jurisdictions, many large companies do not trade on the stock market, and those which do frequently have a dominant shareholder.<sup>119</sup> Anecdotal evidence suggests that throughout continental Europe and East Asia, the internationalization of both product and financial markets is beginning to destabilize traditional ownership structures and cause some form of convergence in the Anglo-American direction.<sup>120</sup> Tangible manifestations of this trend include a significant increase in the number of publicly traded

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115. Lublin, *supra* note 107; *Wallowing in Wages*, ECONOMIST (U.K. ed.), Apr. 6, 2002, at 65; David Leonhardt, *Did Pay Incentives Cut Both Ways?*, N.Y. TIMES, Apr. 7, 2002, sec. 3, at 1; Joann S. Lublin, *Executive Pay Keeps Rising, Despite Outcry*, WALL ST. J., Oct. 3, 2003, at B1.

116. On this possibility, see *supra* notes 86 to 97 and accompanying text; See also Englander & Kaufman, *supra* note 24, at 5, 7; Brett Clegg, *Drawing Lines on Bonuses and Options*, AUSTR. FIN. REV., Nov. 1, 1999, at 28; Fung, *supra* note 81, at 39-40; Ira T. Kay & Steven E. Rushbrook, *The US Executive Pay Model: Smart Business or Senseless Greed?*, WORLDATWORK J., Jan. 2001, at 8.

117. John Armour et al., *Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom*, 55 VAND. L. REV. 1699, 1703-04 (2002).

118. *Id.* at 1703-04, 1750-54.

119. *Id.* at 1704.

120. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 449-52 (2001); Brian R. Cheffins, *Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies*, 23 OXFORD. J. LEGAL STUD. 1, 3-4 (2003) [hereinafter Cheffins, *Bedrock*].

companies and growth in the aggregate market capitalization of national stock markets.<sup>121</sup> If the momentum in favor of dispersed share ownership proves to be robust, the reconfiguration could act as a catalyst for the Americanization of executive pay.

To understand why a shift in ownership patterns potentially matters, it is necessary to consider why managerial remuneration arrangements tend to vary in accordance with a company's ownership structure. Take incentivized compensation, for instance. In a publicly traded corporation with highly dispersed share ownership, a managerial "agency cost" problem may exist that can be addressed at least partially by establishing a strong correlation between executive pay and corporate performance.<sup>122</sup> By contrast, in a firm where control is highly consolidated, the "core" shareholder(s) should have both the means and motivation to discipline disloyal or ineffective managers.<sup>123</sup> Monitoring, then, can at least partially displace the need for performance-related compensation.<sup>124</sup> At the same time, a dominant investor fearing dilution of control will be averse to share-based incentive schemes whereby managers who hit performance targets could be transformed into major shareholders.<sup>125</sup>

Concentrated share ownership is also relevant to the use of incentivized compensation because executives of companies lacking a dispersed investor pattern will have legitimate grounds for being skeptical of rewards based on share price performance. For any business that is not publicly traded, share valuation will be difficult since the stock market will not be functioning as an ongoing barometer of firm value.<sup>126</sup> Even with companies listed on the stock market, those with concentrated ownership structures will typically have a small "free float," which means that share prices could be strongly influenced by

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121. John C. Coffee Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 16-17 (2001); Christoph van der Elst, *The Equity Markets, Ownership Structures and Control: Towards an International Harmonization?*, in Klaus J. Hopt & Eddy Wymeersch, eds., CAPITAL MARKETS AND COMPANY LAW 3, 7-14 (Oxford University Press, 2003).

122. Brian R. Cheffins & Randall S. Thomas, *Should Shareholders Have a Greater Say Over Executive Pay?: Learning From the US Experience*, 1 J. CORP. L. STUD. 286, 308, 312 (2001).

123. Brian R. Cheffins, *Minority Shareholders and Corporate Governance*, 21 COMPANY LAW. 41 (2000).

124. Todd T. Milbourn, *Comment on Colin Mayer's Financial Systems and Corporate Governance*, 154 J. INSTITUTIONAL & THEORETICAL ECON. 170, 174 (1998); Giorgio Brunello et al., *Executive Compensation and Firm Performance in Italy*, 19 INT'L J. INDUST. ORG. 133, 140 (2001); Yun W. Park et al., *Controlling Shareholder and Executive Incentive Structure: Canadian Evidence*, 17 CAN. J. ADMIN. SCI. 245, 246 (2000); Ergun Dogan, *Board Remuneration, Company Performance, and Ownership Concentration: Evidence from Publicly Listed Malaysian Companies*, 19 ASEAN ECON. BULL. 319, 320 (2002).

Similar logic could be applied to lower ranking executives in a company with dispersed share ownership if the chief executive is capable of engaging in careful monitoring and is financially motivated to follow up. See Ryan & Wiggins, *supra* note 38, at 24-25.

125. Thomas Bates et al., *Promotion Incentives and Executive Compensation in Family Firms 17* (2000) (unpublished working paper, on file with the author); Thomas, *supra* note 14, at 124.

126. Thomas, *supra* note 14, at 120.

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“noise” unrelated to prospective future earnings. Under such circumstances, price fluctuations may not reflect in any meaningful way the quality of managerial performance.<sup>127</sup>

There is a body of empirical evidence which confirms that the adoption of highly incentivized executive pay arrangements occurs less readily in companies with a major blockholder.<sup>128</sup> Admittedly, there are some conflicting data.<sup>129</sup> Still, if countries in which concentrated ownership is the norm for large business enterprises are in fact shifting towards a more dispersed pattern, a consequence may be greater momentum in favor of performance-oriented managerial compensation.

The potential reconfiguration of share ownership, in addition to influencing the use of incentive-based executive remuneration, might also affect aggregate pay. On this count, work done by Lucian Bebchuk, Jesse Fried, and David Walker is instructive.<sup>130</sup> They argue that the setting of executive pay in the typical American widely-held company is biased in favor of management, in large part because board committees delegated the task of determining compensation are often more beholden to management than to shareholders. Correspondingly, top executives have considerable scope to extract “rent” in the form of remuneration in excess of the level that would be optimal for shareholders.<sup>131</sup>

Arguably, where core shareholders dominate, “rent extraction” is less likely to occur via managerial compensation.<sup>132</sup> Take the example of a company that has a concentrated ownership structure in which the CEO is not part of the dominant faction. Those with a controlling interest should be motivated to prevent excessive compensation because any “unspent” money reverts to the

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127. Abowd & Kaplan, *supra* note 52, at 155-57; Melis, *supra* note 84, at 353; Mazur, *supra* note 82; Parker-Pope, *supra* note 65. For illustrations of the point, see Maurizio Dallocchio, *Why Do Italian Stocks Read Like Opinion Polls?*, WALL ST. J. EUR., June 11, 2001, at 7; *Throw Out the Rule-Book*, ECONOMIST, May 26, 2001, at 112.

128. Brunello et al., *supra* note 124, at 141, 155; Park et al., *supra* note 124, at 251-52; Paul Durman, *How Different Factors Affect the Level of Pay at the Top*, SUNDAY TIMES, Dec. 9, 2001, at 8 (discussing a report by SCA Consulting); Yun M. Park et al., *Executive Pay Practices of Firms with Dominant Shareholder CEOs: Self-Dealing or Efficient Contracting*, 15 (2002) (unpublished manuscript, available at <http://business.fullerton.edu/finance/yunpark/files/papers/DSCEO.doc>) (last visited Dec. 3, 2004) (finding that executive pay is less stock-based when a CEO is a dominant shareholder than it is when a company lacks a blockholder).

129. Joseph A. McCahery & Luc Renneboog, *Managerial Remuneration: The Indirect Pay-for-Performance Relation*, 1 J. CORP. L. STUD. 317, 331-32 (2001); James J. Cordeiro & Rajarm Veliyath, *Beyond Pay for Performance: A Panel Study of the Determinants of CEO Compensation*, 21 AM. BUS. REV. 56, 59 (2003).

130. Bebchuk et al., *supra* note 15. For additional explanations why concentrated share ownership might be associated with lower levels of executive pay, see Bates et al., *supra* note 103, at 5-6, 10 (finding, however, that the situation would be different with executives below the CEO level); Cordeiro & Veliyath, *supra* note 129.

131. Bebchuk et al., *supra* note 15, at 754, 784-86.

132. *Id.* at 843-45; Ferrarini et al., *supra* note 89, at 11.

shareholders, including those who qualify as “core” investors.<sup>133</sup>

Scrupulous blockholder monitoring of managerial remuneration is much less likely to occur if the chief executive of a company with a concentrated ownership structure is a member of the controlling group or family. Nonetheless, even in such a situation, rent extraction via executive compensation is likely to be muted. To the extent that the dominant faction in a company attempts to exploit the private benefits of control, they will probably take advantage of more clandestine and efficient methods such as diverting promising business opportunities and arranging “sweetheart” deals with related corporations.<sup>134</sup> Certainly, the available empirical evidence suggests that CEOs who are also dominant shareholders are not “overpaid” as compared with other chief executives.<sup>135</sup>

The foregoing suggests that, to the extent that corporate ownership becomes more dispersed in countries where blockholding currently prevails, there likely will be a rise in executive pay levels as well as a shift towards U.S.-style performance-oriented compensation. The attitudes of those likely to buy equity as part of a shift towards increasingly diffuse share ownership would probably reinforce this trend. One hallmark of the alleged transition away from traditional blockholder arrangements is growing foreign portfolio investment by financial intermediaries based in the United States and Britain (pension funds and mutual funds, for example).<sup>136</sup> If companies from continental Europe, Asia, and Latin America want to raise funds on international capital markets, they will be obliged to respond to the preferences of these institutional investors.<sup>137</sup> American and British shareholders have generally sought to promote incentive-oriented managerial remuneration and have been prepared to accept lucrative

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133. Bebchuk et al., *supra* note 15, at 844; Corderio & Veliyath, *supra* note 129; Dogan, *supra* note 124, at 340; Kannan Ramaswamy et al., *A Study of the Determinants of CEO Compensation in India*, 40 MGMT. INT'L REV. 167, 172 (2000). For an example of this process in action, see S. Karene Witcher, *Executive Pay Growth in Asia is Stalling*, ASIAN WALL ST. J., June 2, 1998, at 6.

134. Bebchuk et al., *supra* note 15, at 844-45. For more benign explanations regarding why CEO pay will not be excessive in this instance, see Derek Matthews, *Fat is a Relative Issue*, MGMT. TODAY, June 1996, at 50; Ramaswamy et al., *supra* note 133, at 182-83; Bates et al., *supra* note 125, at 5.

135. Park et al., *Executive Pay*, *supra* note 128, at 13-14; Ramaswamy et al., *supra* note 133, at 171, 182-83; Clifford G. Holderness, *A Survey of Blockholders and Corporate Control*, FED. RES. BANK N.Y. ECON. POL. REV., Apr. 2003, at 51, 56-57.

136. William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J. TRANSNAT'L L. 213, 234 (1999); Mary O'Sullivan, *Corporate Governance and Globalization*, 570 ANNALS AM. ACAD. POL. & SOC. SCI. 153, 167 (2000); Robert Graham, *A Punctured Reputation*, FIN. TIMES, Sept. 29, 1999, at 24; *Lean, Mean & European: Survey of European Business*, ECONOMIST, Apr. 29, 2000, at 9.

137. Sara Calian, *On the Buy Side: Investor-Friendly Firms Sought*, WALL ST. J. EUR., June 26, 2001, at 11; *The End of Tycoons*, ECONOMIST, Apr. 29, 2000, at 93; Thomas Kamm, *Europe's Move into the Free Market Spurs a Massive Corporate Workout*, WALL ST. J., Dec. 30, 1999, at A1; *The Pull of the Markets*, LATIN FIN., Mar. 1, 2001, at 14; see also Patrick J. Lyons, *A Global Vote for US Style of Openness*, N.Y. TIMES, May 9, 1999, § 3, at 4 (finding that the priorities of German and Japanese institutional investors were similar to those of their Anglo-American counterparts).

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compensation for managerial “high-flyers.”<sup>138</sup> Correspondingly, growing Anglo-American cross-border portfolio investment might serve to provide a congenial environment for lucrative performance-based managerial remuneration in countries where share ownership has traditionally been highly concentrated.<sup>139</sup>

While a shift towards dispersed ownership could imply the spread of an increasingly American approach to executive pay, some cautionary notes are in order. Although a growing number of companies outside the United States and Britain are becoming versed in the Anglo-American way of doing business, doubts still exist about whether any shift in attitude is more than superficial.<sup>140</sup> Thus, it cannot be taken for granted that the preferences which U.S. and U.K. investors have concerning executive pay arrangements will have more than a marginal influence for the foreseeable future.

Evidence from continental Europe also suggests that an immediate and radical shift towards substantial ownership dispersion may in fact not be imminent. For instance, while statistical evidence does establish clearly that it is becoming more common for European companies to go public,<sup>141</sup> the general trend among these newly-listed companies is to retain a concentrated ownership structure.<sup>142</sup> Assuming this practice persists, controlling shareholders presumably will continue to predominate even if the current trend toward increased stock market participation remains on track.<sup>143</sup> This could have significant implications for executive pay because the enduring influence of

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138. Cheffins & Thomas, *supra* note 122, at 308, 311-12; see also INTERNATIONAL CORPORATE GOVERNANCE NETWORK, Best Practices for Executive and Director Remuneration (2003), available at <http://www.icgn.org/documents/RemunerationBulletPts.pdf> (outlining the best practice recommendations of an organization of investors representing more than \$10 trillion in assets). U.K. investors, however, are more sceptical of lavish executive pay arrangements than their American counterparts. See Patience Wheatcroft, *GSK and the Seeds of Change*, TIMES (London), May 21, 2003, at 27; Michael Skapinker, *After Garnier: Why Executive Rewards in the US and the UK are Unlikely to Converge*, FIN. TIMES (U.K. ed.), May, 21, 2003, at 21; Sylvia Pfeifer, *Bitter Pill for Glaxo*, SUNDAY BUS. (London), May 25, 2003, at 9.

139. *France's Boardroom Revolution*, WALL ST. J., Oct. 17, 1995, at A20; Gates, *supra* note 8; Leander, *supra* note 4, at 13; David Woodruff, *Europe, A Latecomer, Embraces Options*, WALL ST. J., May 15, 2001, at A18.

140. *The Chaebol Spurn Change*, ECONOMIST, July 22, 2000, at 83; Craig Karmin, *Corporate Governance Issues Hamper Emerging Markets*, WALL ST. J., Nov. 8, 2000, at C1; Peter Martin, *Anglo-Saxon Angst*, FIN. TIMES, Sept. 2, 2000, § FT Money, at 18; Phillip Webster, *Italy's Grand Families Back in the Frame*, SUN. BUS., Aug. 5, 2001, at 14.

141. *Supra* note 121 and related discussion.

142. MARC GOERGEN, CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE: A STUDY OF GERMAN AND UK INITIAL PUBLIC OFFERINGS 51-56, 78-83 (Edward Elgar, 1998) (discussing initial public offerings in Britain and Germany); Wayne H. Mikkelson, *Ownership and Operating Performance of Companies that Go Public*, 44 J. FIN. ECON. 281, 286-89 (1997) (discussing the United States); Marco Pagano, *Why Do Companies Go Public? An Empirical Analysis*, 53 J. FIN. 27, 56-60 (1998) (discussing public offerings in Italy); Martin Holmén & Peter Högfeldt, *A Law and Finance Analysis of Initial Public Offerings* (2000) (unpublished working paper, on file with authors) (discussing initial public offerings in Sweden).

143. Brian R. Cheffins, *Current Trends in Corporate Governance: Going From London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5, 36 (1999).



blockholders will serve to diminish the likelihood of convergence towards the U.S. executive pay model.

### *B. Cross-Border Hiring*

While it cannot be taken for granted that share ownership patterns will soon evolve along Anglo-American lines, there are other economic dynamics that might nevertheless foster a partial executive pay transition. One is the growing internationalization of the labor market for executives. It has been said that “[t]he dawn of the millennium is ushering in a true global marketplace for CEOs, with a record number of foreign CEOs running major companies in the United States, Britain, and several other countries around the world.”<sup>144</sup> If this prognosis is correct, increased cross-border hiring of top management might promote the Americanization of executive pay.

There are various ways in which the growth of the nascent market for global executive talent could prompt a shift to American-style managerial compensation. One dynamic which could be relevant is that companies based outside the United States will fear losing top people. In a global marketplace for executive talent, gifted managers might be tempted to migrate to America to take up generous remuneration packages stateside. Market forces will in turn pressure foreign firms to restructure managerial compensation so as to conform more closely to typical arrangements in the United States.<sup>145</sup>

Increased cross-border hiring of Americans for top posts outside the United States also might help to foster a reconfiguration of executive pay. A foreign company may look stateside to recruit senior managers in order to take advantage of the United States’ comparatively deep executive talent pool.<sup>146</sup> Also, a company may want to signal that maximizing shareholder value is a high priority by hiring a CEO from the country that embraces this notion most firmly.<sup>147</sup> Those aspiring to a top managerial position in the United States are unlikely to leave the country unless a prospective foreign employer offers a compensation package comparable to those which American companies provide.<sup>148</sup> Thus, large-scale recruitment of American executives by non-U.S.

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144. Denis B.K. Lyons & Stuart Spencer, *International CEOs on the Rise*, CHIEF EXEC., Feb. 2000, 51, 51.

145. See, e.g., Tully, *supra* note 58; Martin Dickson, *Package Envy: Or the Curse of Keeping Up with the Yanks*, FIN. TIMES, Apr. 28, 2001, at 13; Dan Bilefsky, *Mad About Money*, WALL ST. J., Apr. 14, 2003, at R3; see also Gates, *supra* note 8 (discussing a survey of large European companies indicating that 78% of total responses cited attracting and retaining executives as among the forces driving change in European executive compensation).

146. Luiza Chwialkowska, *How to Land an American Boss*, NAT’L POST, Sept. 6, 1999, at A3; John Plender, *Cult of the US Manager*, FIN. TIMES, Apr. 14, 1999, at 19.

147. See Plender, *supra* note 146.

148. Delroy Alexander, *Over-Hyped, Overpaid and Over Here*, INVESTORS CHRON., Nov. 24, 1995, at 20; Chwialkowska, *supra* note 146; Matthews, *supra* note 134.

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companies could trigger global changes in approaches to executive pay.<sup>149</sup>

While in theory the emergence of a global market for executive talent may foster convergence in managerial compensation, how important are the relevant dynamics likely to be in practice? According to some evidence, quite a bit. On the “demand side” of the labor market, growing competition for managerial talent apparently is forcing more companies to recruit internationally.<sup>150</sup> Moreover, many large corporations seeking leaders capable of operating effectively in a global marketplace are increasingly willing to select the best managerial talent irrespective of country of origin.<sup>151</sup> Turning to the “supply” side of the equation, there are growing numbers of “true global nomads” who speak English fluently, have honed their business skills in countries outside their own, and are perfectly content to move to further their careers.<sup>152</sup> This international cadre of executives offers companies a wide choice of potential recruits.

Still, it cannot be taken for granted that internationalization of the managerial labor market will be a robust cause of convergence in executive pay.<sup>153</sup> First of all, foreign firms are unlikely to recruit an American to serve as CEO unless he or she speaks the native tongue fluently. Even where language is not a barrier, however, the recruitment of a U.S. chief executive may still tend to be an exceptional event.<sup>154</sup> To illustrate, in Canada, many firms shy away from hiring American CEOs because the large compensation package required to recruit the new person will be too costly and may well create discord among modestly paid incumbent executives.<sup>155</sup> Even in Britain, the most popular destination for Americans taking up a CEO post,<sup>156</sup> hiring directly from the United States is still considered risky.<sup>157</sup> British companies in search of a “U.S.

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149. Parker-Pope, *supra* note 65; Alexander, *supra* note 148; Tony Boyd, *World Class*, AUSTL. FIN. REV., Nov. 8, 2002, at 34; John Kipphoff & Tony Tassell, *UK Pays a Big Price to Keep Up With the US*, FIN. TIMES, May 19, 2003, at 19; *Cf. Cave, supra* note 2 (arguing that the effect of recruiting a U.S. CEO will be transitory unless the company has to go back to the international marketplace to find a replacement).

150. Gross & Wingerup, *supra* note 11, at 26.

151. Lyons & Spencer, *supra* note 144, at 52.

152. Davis, *supra* note 3, at 22; Lyons & Spencer, *supra* note 144, at 51; Stephen Overell, *Changing the Rules of Musical Chairs*, FIN. TIMES (U.S. ed.), Aug. 30, 2002, at 7.

153. Paul Lee, *Not Badly Paid But Paid Badly*, 10 CORP. GOVERNANCE: INT’L REV. 69, 70-71 (2002); ICGN SUB-COMMITTEE ON EXECUTIVE REMUNERATION, *Executive Remuneration – The Caucus Race (A Report to the International Corporate Governance Network)*, ¶ 19 (2002), available at <http://www.icgn.org/documents/remunerationreport.pdf> (last visited Dec. 3, 2004).

154. On potential bias against foreign executives see, for example, Jo Johnson, *A Gift for Much More than Cosmetic Change*, FIN. TIMES, June 27, 2001, at 15; Joann S. Lublin, *American Advantage: It Often Doesn’t Pay to Work for a Foreign Company’s US Unit*, WALL ST. J., Apr. 17, 1991, at R4; Nancy Dunne, *Plugging Into European Jobs No Easy Task*, FIN. TIMES (U.S. ed.), Aug. 22, 2003, at 18.

155. Chwialkowska, *supra* note 146; Gay, *supra* note 66.

156. Lyons & Spencer, *supra* note 144, at 52; see also *Keep on Purring*, ECONOMIST, July 24, 1999, at 25 (finding that fourteen of the thirty-one best-paid executives in Britain were from the United States).

157. Plender, *supra* note 146 (noting that it is more conventional to hire Americans who have risen through the ranks).

superman” typically do so in order to address pre-existing credibility problems and deflect pressure from impatient investors.<sup>158</sup>

Likewise, it cannot be taken for granted that American companies will hire foreign-born managers on a wide scale.<sup>159</sup> Tough immigration regulations constitute a potential deterrent.<sup>160</sup> Also, evidence from Britain and Canada suggests that the number of top executives actually in a position to move remains quite small. In both countries, the argument that senior management might depart to the United States has been invoked to defend significant increases in executive pay.<sup>161</sup> Nevertheless, in Britain, skeptics say that no more than a handful of individuals could really move to the United States and secure a highly lucrative pay deal.<sup>162</sup> In Canada, the prevailing view is that only executives in companies now competing successfully for business in a North American or global marketplace might be able to leave.<sup>163</sup> Thus, most Canadian CEOs have not actively sought opportunities in the United States because many are “landlocked”: they work for small companies that only service the domestic market.<sup>164</sup> The upshot is that, while cross-border hiring is a potential catalyst for Americanized executive pay, the global market for managerial talent is characterized by “continuing stickiness.”<sup>165</sup>

### C. Transnational Mergers and Acquisitions

As with the market for managerial talent, growing internationalization of the market for corporate control could foster a shift in executive compensation.<sup>166</sup>

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158. *Id.* For a mildly dissenting view, see Alexander, *supra* note 148.

159. Overell, *supra* note 152.

160. Jan Hack Katz, *Competition Breeds Efficiency? Then Open the Executive Suite to the Free Market*, L.A. TIMES, May 16, 1997, at B9. Moreover, mindful of security issues, immigration officials are imposing increasingly strict standards on foreigners seeking to work for U.S. companies. Jennifer Fried, *For Many Business Immigration Lawyers, There's Less Green in Green Cards*, MIAMI DAILY BUS. REV., June 20, 2003, at 14.

161. On Britain, see, for example, Peter Martin, *More than Their Job's Worth*, FIN. TIMES, May 15, 1993, at 8; *Thin Excuses for Fat Cats*, THE INDEP. (London), Mar. 6, 1994, at 20; John Waples, *Boardroom Bonanza*, TIMES NEWSPAPERS LIMITED, SUNDAY TIMES (LONDON), July 16, 2000, § 3, at 9. On Canada, see Gay, *supra* note 66; Ann Gibbon, *CIBC Opposes Executive Pay Limit*, GLOBE & MAIL (National Edition), Jan. 17, 1997, at B4.

162. *Look Out, There's a Monster Coming to Your Annual Meeting*, TELEGRAPH, July 25, 2000, at 27; Sally Patten & Jon Ashworth, *UK 'Fat Cats' Look on in Envy at Their American Cousins*, SUNDAY TIMES (LONDON), July 15, 2000, at 29; Simon Targett, *Heat May be Turned Up*, FIN. TIMES, Nov. 17, 2000, at FT Director 7; Jane Simms, *Has the Milk Gone Sour for Fat Cats?*, ACCOUNTANCY (U.K.), Sept. 30, 2002, at 40, 41.

163. David Berman, *A Bad Place to be Boss*, CAN. BUS., July 1997, at 17; Katherine Gay, *Canadian CEOs Pay Makes it Hard to Attract Top Talent*, FIN. POST, Apr. 20, 1996, at 32; Janet McFarland, *Managing Compensation*, GLOBE & MAIL, Nov. 5, 1996, at B17.

164. Bruce Gates, *Well-Paid Canadian Executives Facing a 'Taxing' Problem*, FIN. POST, May 6, 1991, at 24; Gay, *supra* note 66.

165. ICGN SUB-COMMITTEE ON EXECUTIVE REMUNERATION, *supra* note 153, ¶ 19; see also Martin Dickson, *Pay: It's Not Such a Small World After All*, FIN. TIMES, June 25, 2002, at 22.

166. On the nature of the market for corporate control, see Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON UNIV. L. REV. 99, 110-12 (1989).

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Though the combined effects of economic uncertainty and political turmoil have recently taken their toll,<sup>167</sup> cross-border merger and acquisition (M & A) activity has generally been robust over the past decade.<sup>168</sup> Reasons include heightened competitive pressures, improvements in technology and communications, and the growth of global markets for goods and services.<sup>169</sup>

International M & A activity has potentially profound implications for executive compensation packages because when companies with different managerial remuneration arrangements merge, pressure arises to move to a single pay system.<sup>170</sup> Specifically, so long as a strong U.S. element is party to a cross-border merger or acquisition, there will be a shift toward an American-style compensation scheme.

First consider foreign firms making acquisitions in the United States. If the American target previously offered lucrative remuneration packages to its executives, a merger could create huge internal pay inequities. The parent company might then be forced to resolve the problem by increasing home-country executive pay. The alternative—slashing salaries of top management in the United States—would likely be untenable because it would cripple efforts to recruit new people and retain key incumbent talent.<sup>171</sup> For instance, prior to the 1998 merger between Daimler-Benz AG, a German automobile manufacturer, and Chrysler Corporation, an American rival, Chrysler's second-ranking executive made more from salary, bonuses, and share options than the top ten Daimler-Benz executives combined.<sup>172</sup> This type of disparity led the new merged entity—Daimler Chrysler—to try to develop an internal pay system that was equitable on cross-border terms and yet would allow the company to retain and recruit managers to run the American operations.<sup>173</sup> The key initiative taken in this regard was to implement a major stock option plan for which 6,000 executives, including those based in Germany, were eligible.<sup>174</sup>

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167. Peter Thal Larsen & Lina Saigol, *Annus Horribilis for Deal-Making Bankers*, FIN. TIMES, Dec. 28, 2001, at 19; David Telfer, *Uncertainty Taking its Toll on Deals*, says KPMG, ABERDEEN PRESS & JOURNAL, June 30, 2003, at 15.

168. See, e.g., Bernard S. Black, *The First International Merger Wave (and the Fifth and Last US Wave)*, 54 U. MIAMI L. REV. 799 (2000); Fay Hansen, *Global Mergers & Acquisitions Explode*, BUS. CREDIT, June 2000, at 22.

169. Abdel M. Agami, *Cross-Border Mergers Among Multinational Businesses*, MULTINAT'L BUS. REV., Spring 2001, at 77. Other reasons offered for the increase include the liberalization of international trade and capital flows. David Allen, *Global Mergers*, MGMT. ACCT., April 1999, at 50.

170. Fung, *supra* note 81, at 38.

171. Murphy, *supra* note 12, at 2497; *The Best . . . and the Rest*, *supra* note 4, at 16; Gross & Wingerup, *supra* note 11, at 30; J.E. Richard, *Global Executive Compensation: A Look at the Future*, COMPENSATION & BENEFITS REV., May-June 2000, at 35.

172. Cheffins, *Metamorphosis*, *supra* note 10, at 508-9; see also Peter Schneider, *Scenes from a Marriage*, N.Y. TIMES, Aug. 12, 2001, Magazine, at 44, 47.

173. Fung, *supra* note 81, at 37.

174. Kemba J. Dunham, *Home Disadvantage*: WALL ST. J., April 11, 2002, at B12 (noting that because German law does not require corporations to report individual executive salaries, it is unknown whether any DaimlerChrysler executive currently working in the U.S. is paid better than the CEO).

Now consider an American company acquiring a foreign business enterprise. Given the exceptional nature of managerial remuneration in the United States, the executives of the acquired company are unlikely to be nearly as well paid as their American counterparts. If matters remain the same after the merger, dissatisfaction could arise among top people in the acquired company, perhaps leading to harmful defections.<sup>175</sup> As a result, pressure will again exist to move pay in the U.S. direction. Since the presence of a strong American element in a cross-border merger has this sort of effect and because the United States is a major player in such transactions,<sup>176</sup> a prompt return to recent levels of cross-border deal-making should create renewed momentum in favor of U.S.-style executive remuneration.

#### *D. The Growth of Multinational Enterprise*

Cross-border mergers are a manifestation of an even broader trend, the dramatic increase in the number and size of companies that operate multinationally.<sup>177</sup> The growth of multinational enterprises has significant implications for the globalization of executive pay. Business enterprises with cross-border operations often find it useful to coordinate managerial pay arrangements around a universal standard because this makes it easier to organize company-wide systems of promotion and incentivized compensation.<sup>178</sup> For multinational corporations that in fact make “executive pay decisions on a worldwide level . . . more uniform executive pay structures are the result.”<sup>179</sup> Correspondingly, when multinationals headquartered in the United States set managerial pay in accordance with a universal corporate policy, Americanization of executive pay will likely ensue.

Thus, when an American multinational adopts a uniform executive compensation structure, host-country nationals directly employed by the company will end up having their pay aligned more closely with standards prevailing in the United States.<sup>180</sup> Also noteworthy, however, will be the effect on the market for managerial talent in the country in question. Higher pay for

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175. Robert A. Romanchek, *Executive Compensation in a Global Merger*, ACA J., First Q. 1999, at 6.

176. Hansen, *supra* note 168, at 22-23.

177. Douglas M. Branson, *Teaching Comparative Governance: The Significance of ‘Soft Law’ and International Institutions*, 34 GA. L. REV. 669, 669, 672-75 (2000); Gary M. Quinlivan, *The Multilaterals*, WORLD & I, Nov. 2000, at 267.

178. Marc Baranski, *Think Globally, Pay Locally: Finding the Right Mix*, COMPENSATION & BENEFITS REV., July-Aug. 1999, at 15, 20-21; Fung, *supra* note 81, at 38; Mazur, *supra* note 82.

179. Richard, *supra* note 171, at 35.

180. HELEN DERESKY, INTERNATIONAL MANAGEMENT: MANAGING ACROSS BORDERS AND CULTURES 366-67 (Prentice Hall, 3d. ed., 2000); Mazur, *supra* note 82 (making the same point by referring to a UK parent company). Still, when U.S. multinationals use Americans for top management positions in foreign subsidiaries, the top executives can often be segregated in terms of their pay. See Fung, *supra* note 81, at 41.

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locals hired for top posts by American companies will skew the expectation scale and pressure domestic companies to introduce equally remunerative compensation packages so as to attract and retain effective managers.<sup>181</sup> For instance, when American multinationals began awarding growing numbers of stock options to managers working outside the United States in the 1990s, local firms were provoked into adopting this type of compensation.<sup>182</sup>

While some multinationals seek to establish an internationally uniform executive remuneration structure (“globalizer” companies), others prefer to take into account domestic compensation norms, national tax considerations, and other local conditions (“adapter” or “localizer” organizations).<sup>183</sup> The latter type of policy will obviously do little to foster the globalization of executive pay. Organizing managerial pay purely on a country-by-country basis, however, may not be tenable for multinationals headquartered outside the United States that have substantial American operations. Specifically, if such a company sets managerial pay strictly in accordance with local conditions, it would need to offer remuneration that is competitive stateside in order to recruit or retain talented managers to run the U.S. division.<sup>184</sup> This, in turn, could cause disquiet among the parent company’s top executives because they might not be earning as much as their highly paid managerial subordinates in the United States.<sup>185</sup> Also, the firm’s managerial “high-flyers” might lobby noisily for assignments stateside so as to become entitled to lucrative American-style pay packages and then insist on retaining their compensation upon returning to the head office. Faced with such pressures, foreign multinationals operating in the United States might feel compelled to restructure executive pay at the parent company in ways that would foster the globalization of executive pay.<sup>186</sup>

### E. Conclusion

How potent are the various market forces which could foster executive pay convergence? This is a difficult question to answer. More dispersed share ownership in countries where “core” investors now dominate would likely yield increasingly lucrative and performance-based managerial pay packages.

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181. Murphy, *supra* note 12, at 2497; Atul Mitra et al., *Crossing a Raging River*, *WORLDATWORK J.*, 2d Quarter 2002, at 6.

182. TOWERS PERRIN, *supra* note 32, at 3.

183. Fung, *supra* note 81, at 36, 37-38; Mitra et al., *supra* note 181, at 6. Cf. Duncan Brown, *The Third Way: The Future of Pay and Rewards Strategies in Europe*, ACA J., Second Quarter, 2000, at 15, available at <http://www.worldatwork.org> (saying that country-based variations in remuneration remain prevalent in Europe but there are signs of companies evolving towards a “Third Way”).

184. Vikas Bajaj, *Foreign Firms Attracting Talent With Stock Options*, *DALLAS MORNING NEWS*, Sept. 19, 1999, at D23.

185. Berman, *supra* note 163, at 17; Johnston, *supra* note 6; Lublin, *supra* note 154 (focusing on the jealousy that high U.S. pay can generate).

186. Dunham, *supra* note 174.

However, it is uncertain whether such ownership patterns will evolve substantially in the near future.<sup>187</sup> Similarly, cross-border mergers and acquisitions will likely promote the Americanization of managerial remuneration, though current economic uncertainties mean that it may be some time before transnational deal activity returns to levels seen in recent years.

Finally, it must be remembered that, in a general sense, market forces may not wield a decisive influence on the globalization of executive compensation. Instead, various types of legal regulation could deter companies from making American-style pay arrangements.<sup>188</sup> Indeed, as we have already seen, immigration laws are one potential barrier.<sup>189</sup> Rules and guidelines promulgated by private organizations rather than lawmakers (“soft law”) could also impede the globalization of managerial compensation to some degree, as could the business culture in the countries in which companies operate. The next four parts of the Article consider these various possibilities in turn, beginning with an analysis of corporate law.

## V. CORPORATE LAW AND THE GLOBALIZATION OF EXECUTIVE PAY

### A. Direct Regulation

Corporate law encompasses various types of legal rules that might influence the setting of executive pay. Statutory measures that stipulate specifically how executive pay arrangements should be structured—“direct regulation”—have the potential to address the issue in the most forthright manner. Past experiences in India offer a striking illustration of how far the law might go. The Companies Act of 1956 introduced various provisions that dictated how management was to be paid.<sup>190</sup> For instance, total managerial compensation could not exceed 11% of a company’s net annual profits.<sup>191</sup> Also, the remuneration of directors acting in a managerial capacity could not be increased without government approval.<sup>192</sup> The government issued guidelines for permissible increases, including a ceiling on annual pay apparently based upon the prevailing salary of the President of India.<sup>193</sup>

The law on executive pay was liberalized somewhat in India in the early

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187. See *supra* notes 140-142 and accompanying text.

188. Mitra et al., *supra* note 181.

189. See Fried, *supra* note 160 and accompanying text.

190. Companies Act, No. 1 (1956) (India).

191. Companies Act, No. 1 §§ 198, 309. On the origins of the provision and for background, see A. RAMAIA, GUIDE TO THE COMPANIES ACT (ACT 1 OF 1956 AMENDED UP TO DATE), li, lii, 15, 22, 337-40, 503-8 (Madras Law Journal Office, 6th ed., 1971) [hereinafter RAMAIA, 6th ed.].

192. Companies Act, No. 1 § 310. For background on this provision, see RAMAIA, 6th ed., *supra* note 191, at 1, 22, 508-10.

193. On the guidelines, see RAMAIA, 6th ed., *supra* note 191, at 510-12. On the link to the President’s salary, see Ramaswamy et al., *supra* note 133, at 182.

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1990s.<sup>194</sup> This relaxation brought the country more into line with the global norm, as direct regulation of managerial compensation is the exception rather than the rule in industrialized countries. Indeed, corporate law typically does not dictate in any way the nature or scope of executive remuneration.<sup>195</sup>

Nevertheless, in some countries, corporate law does directly regulate executive pay.<sup>196</sup> One approach has been to prohibit a company from paying more than a designated percentage of annual earnings to its directors; Argentina and the Philippines have laws of this sort.<sup>197</sup> Also, certain jurisdictions, such as Australia<sup>198</sup> and Germany,<sup>199</sup> stipulate that executive pay must be “reasonable.” A similar restriction exists in Brazil, where the remuneration of a corporation’s administrators (essentially its directors and executive officers) must be set with due regard for the professional experience of the administrators, their reputation, their duties, and the market value of their services.<sup>200</sup>

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194. Ramaswamy *et al.*, *supra* note 133, at 182. Essentially, unless a company is unprofitable, it is free to work out a suitable remuneration package for its managerial personnel within the limit of a designated percentage of net profits. A. RAMAIYA, *GUIDE TO THE COMPANIES ACT, 1738-44, 2435-50, 2732-61* (Wadhwa & Co., 15th ed., 2001) [hereinafter RAMAIYA, 15th ed.].

195. Eddy Wymeersch, *Current Company Law Reform Initiatives in the OECD Countries: Challenges and Opportunities* (2001) (unpublished manuscript at 26, on file with authors) (discussing Europe); *see also* Canada Business Corporations Act, R.S.C., 1985, c. C-44, s. 125 (Can.); R.C. BEUTHIN & S.M. LUIZ, *BEUTHIN’S BASIC COMPANY LAW, 193-94, 211* (Butterworths, 3d ed., 2000) (discussing South Africa); Ichiro Kawamoto *et al.*, *Japan*, in R. Blanpain & K. Geens, eds., *INTERNATIONAL ENCYCLOPAEDIA OF LAWS: CORPORATIONS AND PARTNERSHIPS 175-76* (Aspen Publishers, 1998) [hereinafter *INTERNATIONAL ENCYCLOPEDIA*] (discussing Japan); WALTER WOON, *COMPANY LAW 251-54* (Sweet & Maxwell, 2d ed., 1997) (discussing Singapore).

196. With respect to the United States, at first glance, sanctions that can be imposed under § 304 of the Sarbanes-Oxley Act of 2002 serve to regulate executive pay. Upon closer examination, however, this does not appear the case. By virtue of statutory amendments made by this Act, a public company’s CEO and CFO must certify the corporation’s periodic financial statements. If a company’s financial statements have to be restated, §304 of the Act provides that the CEO and CFO must pay back bonuses, incentive-based compensation, and equity compensation received during the twelve-month period following the initial filing of the impugned financials. *See* 15 U.S.C. § 7243 (2004). Since this provision can operate regardless of how managerial services contracts might be structured, it appears to function more as a sanction for the filing of inaccurate financial statements than as a method for regulating executive remuneration.

197. In Argentina the amount is 25% of earnings (5% if no dividend is distributed) and in the Philippines it is 10% of net income before tax. *See* *INTERNATIONAL HANDBOOK OF CORPORATE GOVERNANCE* 1, 4, 168 (Thomas Learning, 1996) [hereinafter *INTERNATIONAL HANDBOOK*]; Paul van Nieuwenhove, *Argentina*, in *INTERNATIONAL ENCYCLOPEDIA*; *supra* note 167, at 86.

198. A public company is prohibited from providing remuneration to managers that is not “reasonable” unless the arrangement has been approved by the shareholders. *See* *Corporations Act 2001*, No. 50 (2001) § 211 (Austl.). *See also* *Corporations Amendment (Repayment of Directors’ Bonuses) Act 2003*, No. 25 (2003) (Austl.) (amending various sections of the *Corporations Act 2001* to permit the recovery in bankruptcy proceedings of unreasonable director-related payments).

199. In Germany, most firms that distribute shares to the public do business as a stock corporation or “AG,” and an AG’s management board will be staffed by senior full-time executives. The legislation governing such companies stipulates that the aggregate remuneration of each member of the management board of an AG must bear a reasonable relationship to duties of the particular member and to the financial condition of the company. *See* German Stock Corporation Act (*Aktiengesetz* or *AktG*), of Sept. 6, 1965 (*Legal Gazette* I 1089) § 87, ¶ 1.

200. Eduardo S. Neto & Jorge E.P. Levy, *Brazil*, in *INTERNATIONAL ENCYCLOPEDIA*, *supra* note 195, at 62-63.



Detailed regulations such as those that existed in India would likely constrain a move towards Americanized executive pay.<sup>201</sup> However, the restrictions of the sort just outlined are unlikely to pose a serious obstacle. For instance, Argentina's chief executives have traditionally been among the most highly paid in the world,<sup>202</sup> demonstrating that laws limiting director pay to a percentage of profits apparently do not prevent lucrative compensation arrangements.<sup>203</sup> Similarly, in Australia, following the introduction of its "reasonable" remuneration rule in 1992, the country experienced an "enormous and well-publicized escalation in the rewards for CEOs."<sup>204</sup>

Consistent with the general pattern, in Germany, the requirement that compensation reasonably correspond to the services provided has caused few logistical difficulties.<sup>205</sup> On the other hand, the German provision did provide a legal foundation for "breach of trust" charges brought in 2003 as a result of controversial payments made to senior executives of Mannesmann AG after the company opted to abandon stubborn opposition to a hostile takeover.<sup>206</sup> There was speculation that, if the prosecution succeeded, "Germany [would have] become a scorched earth for international executives" who might be candidates for jobs in the country.<sup>207</sup> Dismissal of the charges, however, seems imminent.<sup>208</sup>

### *B. Breach of Duty and Related Causes of Action*

Even if legislation does not stipulate the structure of executive pay arrangements, judicial regulation remains a possibility.<sup>209</sup> Usually, a company's board of directors is assigned the lead role in determining executive pay,<sup>210</sup> with

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201. See Ashok H. Advani, *From the Publisher*, BUS. INDIA, June 10, 2002, available at 2002 WL 17108218 (discussing how regulation affected executive pay in India).

202. See TOWERS PERRIN, *supra* note 32, at 20, 24 and accompanying text.

203. Since directors in Argentina are not allowed to have service contracts, it may be that Argentina's well-paid executives choose not to serve on the board. INTERNATIONAL HANDBOOK, *supra* note 197, at 8.

204. Henry Bosch, *Looking in the CEO's Pay Packet Has a Cost*, SHARES MAG., Oct. 1998, at 61. For statistics, see Mitchell, *supra* note 13. The statutory provision was first introduced by the Corporate Law Reform Act, No. 210 (1992) § 2 (Austl.).

205. Walter Oppenhoff & Thomas O. Verhoeven, *The Stock Corporation*, in Dennis Campbell ed., BUSINESS TRANSACTIONS IN GERMANY §24.03[1][c][ii][B] (Matthew Bender, 1999). For background on why the relevant provision does not have a major practical impact, see Cheffins, *supra* note 10, at 526-27.

206. *Germany's Fat Cats on Trial*, ECONOMIST, Sept. 27, 2003, at 86.

207. Andrew Bulkeley, *Deutsche Bank Chief Charged*, DAILY DEAL, Feb. 26, 2003, available at 2003 WL 4166932.

208. Patrick Jenkins, *Mannesmann Acquittals Likely*, FIN. TIMES, Apr. 1, 2004, at 19.

209. For a summary of why this is the case, see Randall S. Thomas & Kenneth J. Martin, *Litigating Challenges to Executive Compensation: An Exercise in Futility?*, 79 WASH. U. L.Q. 569, 599-600, 602-03 (2001).

210. CHEFFINS, *supra* note 17, at 660; JAMES D. COX ET AL., CORPORATIONS § 11.4 (Aspen Publishers, 1998); INTERNATIONAL HANDBOOK, *supra* note 197, at 15, 26, 76, 124, 147, 162, 206.

a “supervisory” board in charge when a two-tier board structure is in place (as in Germany, for example).<sup>211</sup> Decisions directors make in this context can potentially be impugned on the basis of breach of duties of care, loyalty, or good faith.<sup>212</sup> In the United States, for example, derivative litigation has been used in numerous instances to challenge managerial remuneration arrangements.<sup>213</sup> These suits are more frequently successful in closely held corporations, but even in publicly traded firms they provide something of a check on managerial remuneration.<sup>214</sup>

Still, while the judiciary can theoretically regulate executive pay in certain instances, it is highly unlikely that suits for breach of duty will significantly affect any trend toward the globalization of executive pay. Certainly, in the United States itself, litigation has done little to stop dramatic overall increases in managerial remuneration.<sup>215</sup> Part of the reason is that American judges have typically been reluctant to meddle in corporate policymaking.<sup>216</sup> Their colleagues in other countries likely will share this deferential attitude.<sup>217</sup>

Moreover, even if judges in a particular jurisdiction were prepared to rule that awarding overly generous remuneration constitutes a breach of duties owed to a company, significant procedural constraints would probably deter litigation. In various civil law countries, shareholders do not have any right to bring derivative actions.<sup>218</sup> In others, those interested in bringing proceedings must own a minimum designated percentage of shares (5% or 10%, for example) to obtain standing.<sup>219</sup> In a common law country, on the other hand, case law can offer exceptions to the principle that breaches of duty by directors must be litigated by the company.<sup>220</sup> These exceptions, however, are narrowly focused

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211. On Germany, see AktG, §§ 87(1), 112. Even if there is a one-tier board, in some countries a remuneration committee composed primarily of outside directors will typically take the lead role in setting executive pay: Cheffins & Thomas, *supra* note 122, at 285, 298 (discussing the United States and Britain).

212. On the law on these duties in various countries, see S.J. Berwin & Co. eds., *DIRECTORS' RESPONSIBILITIES IN EUROPE* 8, 16, 25-27, 34-35, 41-42, 49-51, 57, 67, 74 (1997); BETTY M. HO, *PUBLIC COMPANIES AND THEIR EQUITY SECURITIES* ch. 10 (Kluwer Law International, 1998) (Hong Kong); *INTERNATIONAL HANDBOOK*, *supra* note 197, at 69-70 (Japan); WOOD, *supra* note 195, ch. 8 (Singapore and Malaysia); Neto & Levy, *supra* note 200, at 65-67 (Brazil).

213. For empirical evidence on such litigation, see Thomas & Martin, *supra* note 209, at 573-93.

214. *Id.* at 586-87. On publicly traded companies, see, e.g., *In re Walt Disney Co. Derivative Litigation*, 825 A.2d 275 (Del. Ch. 2003).

215. Thomas & Martin, *supra* note 209, at 601-02, 605.

216. *Id.* at 601-02.

217. CHEFFINS, *supra* note 17, at 674 (UK); Cheffins, *supra* note 10, at 527-28 (Germany); Zoher Adenwala, *Directors' Generous Remuneration: To Be or Not to Be Paid*, 3 BOND L. REV. 25, 30 (1991); Benjamin Alarie, *Executive Compensation and Tax Policy: Lessons for Canada from the Experience of the United States in the 1990s*, 61 U. TORONTO FAC. L. REV. 39, 62-63 (2003).

218. Matthias W. Stecher et al., *General Report*, in Matthias W. Stecher ed., *PROTECTION OF MINORITY SHAREHOLDERS* 1, 9-10 (Kluwer Law International, 1997).

219. *Id.* The position is the same in Brazil: Neto & Levy, *supra* note 200, at 65.

220. On England, see *Foss v. Harbottle* 67 Eng. Rep. 189 (Q.B. 1843); *Edwards v. Halliwell*, 2 All E.R. 1064 (Eng. C.A.). Jurisdictions where the same basic rules apply include Ireland (Stecher, *supra*

and are usually of little assistance to a disgruntled minority shareholder.<sup>221</sup> In some common law jurisdictions such as Canada, South Africa, and Australia, the standing rules have been liberalized somewhat by statute.<sup>222</sup> Still, the fact that recovery is the right of the company rather than the shareholder conducting the litigation will likely cause investors to conclude that suing is more trouble than it is worth.<sup>223</sup>

In a number of common law jurisdictions, the logistical difficulties just discussed can be overcome by statutory measures that authorize the judiciary to grant a remedy to a shareholder unfairly prejudiced by a company's actions.<sup>224</sup> With such a provision, a minority shareholder can sue without having to finesse the procedural constraints associated with derivative litigation.<sup>225</sup> Also, since recovery is the right of the shareholder seeking relief rather than the company, the remedy granted can be tailored to the applicant's personal considerations.<sup>226</sup> Still, while there is case law to indicate that excessive remuneration can qualify as "unfairly prejudicial" conduct,<sup>227</sup> the judiciary has proved reluctant to grant relief under the relevant statutory provisions where a company is traded on the stock market.<sup>228</sup> As a result, proceedings brought under the unfair prejudice remedy are unlikely to significantly affect those businesses in which globalization of executive pay is most likely to occur, namely publicly traded companies.

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note 218, at 9), Hong Kong (HO, *supra* note 212, at 629-40); Malaysia and Singapore (WOON, *supra* note 195, at 327, 343, noting that Singapore's statutory derivative action is only available companies that are not publicly traded).

221. CHEFFINS, *supra* note 17, at 315-16, 665-66.

222. BEUTHIN & LUIZ, *supra* note 195, at 155-56 (South Africa); Brian R. Cheffins, *Reforming the Derivative Action: The Canadian Experience and British Prospects*, 1 COMPANY FIN. & INSOLV. L. REV. 227, 234-35 (1997) (Canada); Corporations Act 2001, ss. 236-237 (Austl.).

223. Cheffins, *supra* note 222, at 256-58. Cf. Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351 (2001) (noting that Japanese shareholders have weak incentives to bring derivative litigation but explaining the launching of proceedings of this type by reference to attorney motives).

224. See, e.g., Companies Act 1985, c. 6, s. 459 (Eng.); DENIS H. PETERSON, SHAREHOLDER REMEDIES IN CANADA § 18.15 (Butterworths, 1989) (outlining Canadian statutory provisions); Corporations Act 2001, s. 232 (Austl.); HO, *supra* note 212, at 657-58 (outlining the position in Hong Kong); WOON, *supra* note 195, at 158-60 (discussing Singapore and Malaysia).

225. CHEFFINS, *supra* note 17, at 345.

226. Cheffins, *supra* note 222, at 242.

227. PETERSON, *supra* note 190, § 18.96; Andrew Defina et al., *What is Reasonable Remuneration for Corporate Officers? An Empirical Investigation Into the Relationship Between Pay and Performance in the Largest Australian Companies*, 12 COMPANY & SEC. L.J. 341, 342-44 (1994).

228. HO, *supra* note 212, at 662, 667; J.H. FARRAR & B.M. HANNIGAN, FARRAR'S COMPANY LAW 450-51 (Butterworths, 4th ed., 1998). Cf. KEVIN P. MCGUINNESS, THE LAW AND PRACTICE OF CANADIAN BUSINESS CORPORATIONS 966-67 (Butterworths, 1999); G.P. Stapledon, *Use of the Oppression Provision in Listed Companies in Australia and the United Kingdom*, 67 AUSTRALIAN L.J. 575, 576-78 (1993). In the United States, the equivalent statutory provisions often restrict applications so they can only be made in closely held companies. See legislation discussed in F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 9.27 (Thompson/West, 3d ed., 2000).

C. Shareholder Voting

Legally mandated shareholder voting constitutes another constraint that corporate law can impose on executive pay arrangements. Again, a company's board of directors most often will have responsibility for setting executive pay.<sup>229</sup> At the same time, though, corporate legislation may stipulate that the shareholders have some say. For instance, in certain jurisdictions, laws governing the issuance of equity and corporate "buy-backs" of shares mandate that shareholders pass a resolution endorsing the creation of stock options for top management before such compensation can be granted.<sup>230</sup> Also, in 2002, Britain enacted measures requiring shareholders in publicly traded companies to vote annually on executive pay arrangements.<sup>231</sup> Still, the vote is advisory only, in the sense that a "no" verdict has no effect on entitlements under validly negotiated managerial services contracts.<sup>232</sup>

Another approach some countries use to involve shareholders in determining executive pay is to give those owning equity the right to fix yearly the total remuneration to be awarded to the directors.<sup>233</sup> This apparently sweeping power can be greatly qualified, however, since the packages upon which shareholders vote may not encompass managerial services contracts.<sup>234</sup> Under such circumstances, any veto the shareholders have will only relate to compensation awarded to individuals acting *qua* director (fees for attending meetings, for example).

The intention underlying the various statutory provisions giving owners of corporate equity a vote presumably is to impose a check on excessive

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229. *Supra* note 131 and related discussion.

230. See *supra* notes 84 and 90 and accompanying text (discussing Germany and Japan). The position is the same, for example, in France: Francois Marty & Jean-Francois Dumas, *France Opens up the Options*, 8 INT'L TAX REV., July 1997, at 52.

231. Companies Act 1985, s. 241A, introduced by Directors' Remuneration Report Regulations 2002, SI2002/1986, § 7.

232. Rory Cray and David Cullington, *Directors' Remuneration Reports*, PRACTICAL L. COMPANY, Nov. 2002, at 29, 31.

233. ROBERT BAXT ET AL., AUSTRALIAN CORPORATIONS & SECURITIES REPORTER ¶ 41, 620 (North Ryde, NSW: CCH Australia, 1990) (discussing Australia); JEAN-PIERRE LE GALL AND PAUL MOREL, FRENCH COMPANY LAW 104 (Longman, 2d ed., 1992) (discussing France); M.T. Kreek & S.E. Eisma, *Netherlands*, in INTERNATIONAL HANDBOOK, *supra* note 197, at 60 (discussing the Netherlands); Rolf Skog, *The Swedish Corporate Governance System and International Corporate Governance Debate - A Letter to Katherine*, in Mette Neville & Karsten E. Sorensen eds., THE INTERNATIONALISATION OF COMPANIES AND COMPANY LAWS 123, 128 (DJOF Publishing, 2001) (discussing Sweden); Kawamoto et al., *supra* note 195, at 176 (discussing Japan); Neto & Levy, *supra* note 200, at 63 (discussing Brazil); van Nieuwenhove, *supra* note 197, at 86 (discussing Argentina).

234. In Brazil, this is the case with administrators who are hired as employees rather than being elected by the shareholders: E-mail from Rachel Sztajn, Univ. of Sao Paolo, to Brian Cheffins (on file with authors). In the Netherlands, the corporate constitution can displace the rule that shareholders must vote and the board in fact does normally settle the terms of the service contracts of managing directors: P. SANDERS, DUTCH COMPANY LAW 72 (Oyez, 1977). In France, the directors settle all executive service contracts. See LE GALL & MOREL, *supra* note 233, at 114.

managerial remuneration.<sup>235</sup> Yet, regardless of how the particular rules are formulated, it is doubtful that they can ever act as the safeguard that regulators seemingly expect them to be. First consider companies with a controlling shareholder. Statutory measures requiring remuneration issues to be put to a vote may effectively give the dominant investor a veto over changes falling within the scope of the relevant rules. On the other hand, a “core” shareholder will be well-situated to influence executive pay regardless of whether a shareholder resolution is specifically required or not.<sup>236</sup>

What will the situation be in companies with dispersed share ownership? The experience in the United States and Britain, where a diffuse share ownership pattern is typical for publicly traded companies, provides a possible guide. In these two countries, the available empirical evidence suggests that shareholder voting only functions as a potential check on executive pay when arrangements deviate far from the norm.<sup>237</sup> Again, certain countries in which concentrated share ownership is the norm for large business enterprises may be shifting towards the more diffuse Anglo-American pattern.<sup>238</sup> The experience in the United States and Britain implies that this sort of shift would not cause shareholder voting to emerge as a significant determinant of executive pay.

#### *D. Restrictions on the Distribution of Shares to Executives*

When a company has established a stock option plan for its executives, it must be able to satisfy its obligations when the options are exercised. The most straightforward way to do this is either to issue new shares to the option holders or to repurchase outstanding equity to sell to the executives.<sup>239</sup> In many jurisdictions, however, the issuance of new equity is heavily regulated, and share buy-backs may be prohibited except under special circumstances.<sup>240</sup> Such regulations, therefore, may make it impractical for companies to grant stock options.

The German experience is illustrative. The country’s stock corporations are

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235. See, e.g., Kawamoto et al., *supra* note 195, at 175-76 (discussing Japan).

236. *Supra* note 132 and accompanying text.

237. Cheffins & Thomas, *supra* note 122, at 43; Randall S. Thomas and Kenneth J. Martin, *When is Enough, Enough? Market Reaction to Highly Dilutive Stock Option Plans and the Subsequent Impact on CEO Compensation*, J. CORP. FIN. (forthcoming 2004). The introduction of a mandatory advisory vote in Britain in 2002 does not appear to have changed the situation since only in very rare instances have shareholders voted down what has been proposed. See Clay Harris, *Aegis Shareholders Reject Chief’s Deal*, FIN. TIMES, May 27, 2004, at 1 (describing Aegis Group, a marketing services company, as joining “a select club of UK companies” that had suffered a “no” vote).

238. See *supra* notes 120-121 and accompanying text.

239. Cheffins, *Metamorphosis*, *supra* note 10, at 14.

240. See, e.g., Shaun W. Thorpe ed., COMPANY LAW IN EUROPE B62, D60-61, EC 88, F50, H48, P42, Q66 (1995) (discussing pre-emptive rights in various European countries and European Union company law measures governing share repurchases); WOON, *supra* note 195, at 592-95 (discussing share repurchases in Singapore and Malaysia); van Nieuwenhove, *supra* note 197, at 66, 70 (discussing pre-emptive rights and share repurchase rules in Argentina).

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only permitted to issue and repurchase shares under tightly prescribed circumstances, and satisfying option rights exercised by top executives traditionally did not qualify as a legally valid exception.<sup>241</sup> As a result, firms could only make stock options available to executives by granting bonds that could be converted into shares of the company (convertible bonds) or that had a warrant attached granting the right to acquire shares upon exercise (warrant bonds).<sup>242</sup> The situation was similar in Japan, Finland, and South Korea.<sup>243</sup>

Since stock options are a pivotal aspect of the U.S. pay paradigm, rules effectively precluding companies from using this form of remuneration inevitably will at least partially hamper the Americanization of managerial compensation. Still, due to deregulation, such restrictions are of diminishing importance. During the late 1990s, Germany, Japan, South Korea, and Finland all liberalized their statutory rules to make it easier for corporations to grant stock options to executives.<sup>244</sup> In these countries, deregulation was not fully implemented: shareholder approval still must be obtained before a company can issue or buy back shares and thereby transfer equity to executives who have exercised stock options.<sup>245</sup> Still, the law now constitutes less of a deterrent to the Americanization of executive pay than previously. Indeed, large numbers of German and Korean companies have taken advantage of reform to begin granting stock option plans.<sup>246</sup> This has also been the case in Japan, though concerns persist that the law remains too restrictive.<sup>247</sup>

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241. Ingrid Kalisch, *Stock Options: Will the Upcoming Amendment of the German Stock Corporation Act Facilitate Their Introduction by German Stock Corporations?*, 9 INT'L CORP. COMM. L. REV. 111, 112-14 (1998); Uwe Seibert, *Control and Transparency in Business (KonTraG): Corporate Governance Reform in Germany*, 10 EUR. BUS. L. REV. 70, 74 (1999).

242. Kalisch, *supra* note 241, at 112-14.

243. See generally *The Best . . . and the Rest*, *supra* note 4, at 13. On Japan, see Akira Kawamura, *Introduction of Stock Option*, 12 J. INT'L BANKING L. N-226 (1997); Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Governance Debate*, 91 NW. U. L. REV. 865, 890 (1999). As both authors note, in 1995 the legal regime was partially liberalized for new businesses approved by the Ministry of International Trade and Industry but only a small number of companies sought such approval.

244. *The Best . . . and the Rest*, *supra* note 4, at 13. For example, in South Korea, regulations dealing with the issuance of shares were amended so as to permit companies to satisfy their obligations under stock option plans (Kon-Sik Kim & Chong-Kee Lee, *South Korea in INTERNATIONAL ENCYCLOPEDIA*, *supra* note 167, at 85). The same was done in Germany and Japan and changes were also made to the rules governing share buy-backs. See Maximilian Grub, *The Concept of Corporate Governance and Recent Developments in Germany*, CORP. GOVERNANCE INT'L, issue #4, at 20, 24-25; Florian Haase, *Stock Option Schemes in Germany*, 23 COMPANY LAW. 223, 223 (2002); Kawamura, *supra* note 243, at N-226-27 (Japan).

245. See *supra* note 244 and accompanying text.

246. Woodruff, *supra* note 139; *105 Listed Firms Introduce Stock Options This Year*, KOREA HERALD, Oct. 20, 2000, available at 2000 WL 27394960.

247. On the growing popularity of stock options, see sources cited *supra* note 91. On concerns with the state of the law, see Alexandra Harney, *Cracks Widen in Japan's Commercial Code*, FIN. TIMES, Aug. 17, 2000, at 25.

*E. Disclosure*

“Direct regulation,” shareholder litigation, shareholder voting requirements, and rules governing the distribution of corporate equity thus seem unlikely to be important determinants of the Americanization of executive pay. On the other hand, another set of corporate law rules could constitute a significant variable. These are measures requiring periodic public disclosure of corporate executives’ compensation packages.<sup>248</sup>

The extent to which disclosure of executive pay is mandated varies widely around the world. In the United States, under Securities and Exchange Commission (SEC) rules, when a corporation’s management team contacts investors to solicit proxy votes for the stockholders’ annual meeting, the corporation must send a highly detailed report on executive pay prepared by the board of directors or a compensation committee acting on behalf of the board. The report, in addition to describing the corporation’s general approach to executive pay, must offer a detailed breakdown of compensation arrangements for the CEO and the next four highest-paid executive officers.<sup>249</sup> Britain, Canada, and Australia have disclosure rules that match the SEC standards or come fairly close.<sup>250</sup> France, Italy, the Netherlands, and Sweden also regulate the topic quite closely; in each jurisdiction, companies must provide individualized pay details for top executives.<sup>251</sup>

In contrast, disclosure regulation elsewhere tends to be lax. Indeed, some

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248. Prospectus regulation is also potentially relevant on the disclosure front when a company is planning to make stock option grants or create incentive schemes where equity will be distributed to executives. See Mary Carter & Mary Bryson, *International Employee Stock Plans: Part 1*, GLOBAL COUNS., June 2001, at 21; Jocelyn Mitchell, *Share Schemes and the International Company*, IN-HOUSE LAW., May 1997, at 43. Prospectus regulation is not dealt with in detail here because the experience in America suggests that its presence or absence is unlikely to affect significantly the spread of U.S.-style executive pay. In the United States, the relevant rules are potentially rigorous (Carter & Bryson, *supra*, at 24) but stock option plans are nevertheless used more widely than they are in any other country.

249. Items 402(a)(2), (a)(3), (b), (k) of Regulation S-K, 17 C.F.R. § 229.402(a)(2), (a)(3), (b), (k) (2000). To be more precise, the board is obliged to describe the corporation’s general approach to executive pay and, in a table organized according to SEC specifications, specify how much was paid to each of the five most highly paid executives in the form of salary, bonuses, share options, and other designated categories. The directors must also prepare a performance graph allowing investors to evaluate the corporation’s shareholder return over a five year period in comparison with a “peer group” index and with a well-known stock market index such as the Standard and Poor’s 500: Item 402(l) of Regulation S-K, 17 C.F.R. 229.402(l) (2000).

250. On the fact that disclosure standards in Britain and Canada are fairly close to those which exist in the United States, see Conyon & Murphy, *supra* note 19, at F643; Xianming Zhou, *CEO Pay, Firm Size, and Corporate Performance: Evidence from Canada*, 33 CAN. J. ECON. 213, 216 (2000). On the law in Australia, see Michael Quinn, *The Unchangeables – Director and Executive Remuneration Disclosure in Australia*, 10 AUSTR. J. OF CORP. L. 1, 92 (1999).

In Britain, until 2002, disclosure of executive pay was regulated by the listing rules that apply to publicly traded companies. There has now been a shift to a statutory format. See Companies Act, 1985, s. 234B, schedule 7A, introduced by Directors’ Remuneration Report Regulations (2002), Statutory Instrument 2002/1986, §§ 3, 9.

251. Ferrarini et al., *supra* note 89, at 20-24.

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jurisdictions do not have any reporting requirements at all.<sup>252</sup> More commonly, corporations eligible for stock market listing must identify aggregate director remuneration.<sup>253</sup> These companies are not required, however, to publish specific details on each director's remuneration, to break down the types of compensation, or to otherwise offer details on performance-related pay.<sup>254</sup>

The approach which a country takes towards disclosure of executive pay will likely exert some influence on any possible shift toward American-style executive pay. Anglo-American institutional investors are keen on remuneration schemes that give management incentives to maximize shareholder value, and might be expected to promote this agenda globally.<sup>255</sup> Disclosure regulation could affect their ability to do so since the availability of data on executive pay will determine to some degree the costs of shareholder monitoring.<sup>256</sup> The comments offered by a former securities regulator when the Canadian province of Ontario bolstered disclosure regulation in 1993 make the point well: "Good corporate governance relies on an informed and active investor community. In some respects, this legislation recognizes their legitimate need for information that enables them to relate management's performance to the performance of the company."<sup>257</sup> Indeed, the available Canadian empirical and anecdotal evidence suggests that enhanced disclosure regulation had the effect predicted and helped to cause a shift towards incentivized managerial pay in publicly traded companies.<sup>258</sup>

In addition to fostering incentive-oriented compensation, greater disclosure may facilitate a shift towards the U.S. pay model by accelerating increases in executive remuneration.<sup>259</sup> As Charles Elson, an American

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252. David Woodruff, *A Vanishing European Taboo*, WALL ST. J., Sept. 11, 2000, at A28.

253. See, e.g., Ferrarini et al., *supra* note 89, 24-29 (describing arrangements in Germany, Austria, Spain, Belgium, Luxembourg, Denmark, Finland, Greece and Portugal); INTERNATIONAL HANDBOOK, *supra* note 197, at 4, 77, 94, 106, 201 (discussing Argentina, Japan, Malaysia, Singapore and South Korea).

254. This point has been made in relation to Germany by Jeffrey N. Gordon, *Corporate Governance: Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany*, 5 COLUM. J. EUR. L. 219, 236 (1999), (making this point in relation to Germany though it apparently applies generally).

255. See *supra* note 138 and accompanying text.

256. Ferrarini et al., *supra* note 89, at 14-15; see Edward M. Iacobucci, *The Effects of Disclosure on Executive Compensation*, 48 U. TORONTO L.J. 489, 497-501 (1998).

257. Quoted in Iacobucci, *supra* note 256, at 497.

258. *Id.* at 502-3; Yun M. Park et al., *Executive Pay and the Disclosure Environment*, 24 J. FIN. RES. 347 (2001). Note, though, that research conducted in New Zealand, which bolstered executive pay disclosure somewhat in the early 1990s, does not reveal the same pattern. See Aleksandar Andjelkovic et al., *Public Disclosure of Executive Compensation: Do Shareholders Need to Know?* (unpublished working paper, on file with authors, 2000); Fayez A. Elayan, *Executive Incentive Compensation Schemes and Their Impact on Corporate Performance: Evidence from New Zealand Since Legal Disclosure Requirements became Effective (2001)* (unpublished working paper) (on file with authors).

259. See Iacobucci, *supra* note 256, at 504-17 (discussing somewhat different versions of the thesis presented here); Mark J. Lowenstein, *The Conundrum of Executive Compensation*, 35 WAKE FOREST L. REV. 1, 23-24 (2000).



academic specializing in corporate governance, has observed: "The normal trend is the more that's out there about how much people get, the more they get."<sup>260</sup> To elaborate, when detailed disclosure is mandated, both managers and board members who set executive pay will be able to find out readily the "market rate" offered by competitors in the same industrial sector and by firms of a similar size. Therefore, the executives of a company paying below the norm will be fully aware of their inferior position in the compensation hierarchy and they may seek adjustments accordingly. A perceived loss of social status could fuel their demands on this count.<sup>261</sup> Those who set executive remuneration might well be sympathetic to such claims, particularly if a company's frugal compensation packages are perceived as a tacit admission that the management team is "below average."<sup>262</sup> Fears that valued executives will defect to rivals offering more generous terms will also likely stoke higher pay.<sup>263</sup>

If all companies ultimately seek to match or exceed the "market rate," the inevitable result will be an upward "ratchet" in pay.<sup>264</sup> Consistent with this reasoning, some speculate that British, Canadian, and Australian lawmakers' introduction of more rigorous executive pay disclosure requirements in the 1990s resulted in accelerated increases in managerial remuneration.<sup>265</sup> Empirical work using Canadian data indicates that such suspicions are well-founded.<sup>266</sup>

It is ironic that increased disclosure might contribute to an American-style executive pay spiral because those who fret that top managers are paid "too much" are often keen supporters of reform.<sup>267</sup> For instance, when Ontario bolstered executive pay disclosure in 1993, the left-wing administration then in office was concerned about the excesses of free-market economics. One columnist in a leading Canadian newspaper suggested that the "real motivation" for reform "was to plunge the population into an egalitarian snit over the money paid to the capitalist scoundrels who run private-sector corporations."<sup>268</sup> Matters

260. Quoted in Patrick McGeehan, *Disclosing Pay of Executives Often Leads to Raises*, N.Y. TIMES, October 11, 2003, at C5.

261. Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1041-42 (1999).

262. *Room at the Top* (Editorial), FIN. TIMES, Feb. 19, 1999, at 19.

263. Peter Rodgers, *The Greenbury Effect: Is it Pushing Pay Higher?*, INDEP. (London), Apr. 26, 1996, at 21.

264. See *id.*; see also *How Greenbury Has Boosted Executive Excess*, THE INDEP. (London), June 29, 1996, at 17.

265. On Britain, see Rodgers, *supra* note 263; THE COMMITTEE ON CORPORATE GOVERNANCE, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE ¶ 4.5 (1998) [hereinafter HAMPPEL REPORT; the Committee was chaired by Sir Ronald Hampel]. On Canada, see Iacobucci, *supra* note 256, at 512; Barbara Shecter, *Canadian CEOs Enjoy Average 8% Hike in Compensation*, FIN. POST, Sept. 25, 1996, at 5. On Australia, see Saville, *supra* note 93.

266. Park, *Executive Pay*, *supra* note 128.

267. See, e.g., CHEFFINS, *supra* note 17, at 699; Rodgers, *supra* note 263; *Power Politics*, AMERICAN STYLE, ECONOMIST, Feb. 25, 1995, at 67.

268. Terence Corcoran, *Executive Pay is Not About Social Justice*, GLOBE & MAIL, May 14, 1994, at B2; see also Terence Corcoran, *Raestone Kops Storm Executive Suite*, GLOBE & MAIL, Oct. 16, 1993,

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did not quite work out as planned. In 2001, the same columnist observed: "So far, the only impact of the disclosure has been to drive compensation higher as companies now compete more aggressively for talent."<sup>269</sup>

If extensive disclosure regulation does indeed provide a hospitable platform for American-style executive pay arrangements, recent legislative trends are potentially very significant. For instance, rules requiring French, Italian, and Dutch companies to disclose the pay of top corporate officials on an individualized basis have all been introduced in the past few years.<sup>270</sup> Moreover, additional changes are in the making. The Towers Perrin stock options study discussed earlier anticipates moderate or significant changes to the disclosure laws in sixteen of the twenty-two jurisdictions covered.<sup>271</sup> Perhaps, then, "secrecy is on the way out for executive pay."<sup>272</sup> If so, reform may, perhaps somewhat counter-intuitively, foster a shift towards the lucrative performance-oriented compensation packages prevalent in the United States.

### VI. OTHER LEGISLATION

#### A. Tax

Regulations outside the realm of corporate law rules could also affect the globalization of executive pay. Tax rules constitute one example. To illustrate, income tax rates to which executives are subject likely will influence whether the lucrative managerial compensation associated with the United States becomes increasingly commonplace elsewhere. All else being equal, corporate executives should be more highly paid in a country where the top marginal tax rate (the rate applicable to any further taxable income) is low. Executives will value generous remuneration more highly in a liberal tax environment because they will be able to keep more of what they earn. Since a typical company will tailor compensation arrangements to match managerial preferences, a lower income tax rate should therefore be correlated with higher executive pay.<sup>273</sup> The available historical and empirical evidence indicates that the two are indeed linked.<sup>274</sup> Tax rules may also influence the use of stock options. Towers

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at B2.

269. Terence Corcoran, *Executive Hunting Season*, NAT'L POST, Apr. 3, 2001, at C19.

270. Ferrarini et al., *supra* note 89, 20-22; *Growing Transparency in France About Chief Executives' Pay*, LES ECHOS, May 3, 2001, at 1.

271. TOWERS PERRIN, *supra* note 78, at 15.

272. Woodruff, *supra* note 139 (quoting the proprietor of a U.S.-based corporate governance consultancy).

273. CHEFFINS, *supra* note 17, at 704.

274. *Id.* at 704 (discussing the history in the United States and Britain); John M. Abowd & Michael L. Bognanno, *International Differences in Executive and Managerial Compensation*, in Richard B. Freeman & Lawrence F. Katz eds., *DIFFERENCES AND CHANGES IN WAGE STRUCTURES* 67, 85-87, 91-92, 95 (University of Chicago Press, 1995). For additional supporting anecdotal evidence, see Margaret

Perrin's 2001 study of stock options cited taxation as a key determinant of stock option implementation in a majority of the countries covered.<sup>275</sup> This finding is consistent with speculation that unfavorable treatment under personal income tax laws accounts for the relatively unimportant role of stock options outside the United States.<sup>276</sup> The experience in a number of countries confirms that tax rules can matter. In Britain, for example, tax changes carried out in the 1980s are often cited as being a catalyst for the current popularity of executive share options.<sup>277</sup> Over the past decade, Japan, India, and a number of continental European jurisdictions have restructured their tax rules so as to reduce the tax burden for an employee whose employer grants stock options.<sup>278</sup> These reforms have reputedly encouraged the awarding of this type of compensation.<sup>279</sup>

Work done by economists John Abowd and David Boganno suggests, however, that the importance of tax rules cannot be taken for granted. Using data from the period 1984-1992, they examined how stock options were taxed in twelve countries with the aim of discovering whether differences in tax rules correlated with the popularity of stock-based incentive pay. The study concluded that tax treatment of stock options did not explain in any meaningful way the proportion of stock options relative to other types of remuneration.<sup>280</sup>

Abowd and Boganno's findings need to be qualified, however, in that the position of corporations granting stock options was not taken into account. The experience in the United States shows why this is a significant consideration. Under American tax law, executives' gains from exercising share options are typically deductible from corporate profits as an ordinary business expense.<sup>281</sup>

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Lyons, *Australia's Top Executives: Are They Paid Too Much*, BUS. REV. WKLY., Nov. 16, 1990, at 52; Lublin, *supra* note 64; David Woodruff, *Across Europe, CEOs Get No Respect*, WALL ST. J., June 17, 2002, at A9 (discussing the impact of high rates of income tax on executive pay in Denmark).

275. TOWERS PERRIN, *supra* note 78, at 10.

276. *Belgium Revamps Stock Options*, 10 INT'L TAX REV. 5 (Apr. 1999) [hereinafter *Belgium Revamps*]; Chwialkowska, *supra* note 146; Kevin J. Delaney & David Wessel, *Lumpy Gravy: Suppose Stock Options Involved More Pain than Financial Gain*, WALL ST. J., Dec. 21, 1999, at A1; Mohan Monteiro & Keyur Shah, *India Clears the Way for Stock Options*, 11 INT'L TAX REV. 17 (Dec. 1999/Jan. 2000); Tully, *supra* note 58.

277. Don Egginton et al., *Executive and Employee Share Options: Taxation, Dilution and Disclosure*, 23 ACCT. & BUS. RES. 363 (1993); Kay, *supra* note 82; Tully, *supra* note 58.

278. STOCK OPTIONS (S.J. Berwin & Co., 1999); Monteiro & Shah, *supra* note 276; Bob Zukis, *Japan and USA Compared*, BENEFITS & COMPENSATION INT'L, Sept. 1, 1997, at 9; European Private Equity and Venture Capital Association Special Paper, at 17, 19, 23, 25, 27, 31 (on file with authors) (describing changes enacted in a variety of European countries).

279. *Belgium Revamps*, *supra* note 276; Jill Eswick, *Relative Values*, EMP. BENEFIT NEWS, June 15, 2001, available at 2001 WL 7984504; Woodruff, *supra* note 139; Zukis, *supra* note 278, at 6. Spain is an exception to the typical pattern since there has been tax reform recently but this did not liberalize the relevant rules. Delaney & Wessel, *supra* note 276.

280. Abowd & Bognanno, *supra* note 274, at 92-95. Smith and Watts reached a similar conclusion in their analysis of the tax effects of executive compensation in the United States. Smith & Watts, *supra* note 81, at 361.

281. I.R.C. § 83(h); Conyon & Murphy, *supra* note 19, at 665; Brian J. Hall & Jeffrey B. Liebman, *The Taxation of Executive Compensation*, 14 TAX POL'Y ECON. 1, 7-9 (2001). By virtue of section 422(a)(2) of the Internal Revenue Code, a tax deduction is not available to a corporation that awards

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Thus, when a senior manager exercises stock options, the corporation receives a deduction equal to the difference between the market price of the shares and the exercise price. The American position is very much the exception rather than the rule. In other countries, a company generally cannot treat gains from exercising share options as deductible, since no out-of-pocket expense is incurred.<sup>282</sup> Conyon and Murphy's study of CEO pay in America and Britain suggests that this difference in tax treatment accounts in part for the greater popularity of executive share options in the United States.<sup>283</sup>

Though the tax status of corporations might affect the use of stock options, it cannot be taken for granted that this will be a pivotal variable. Instead, there is empirical evidence suggesting that U.S. corporations that do not benefit from stock options' tax deductibility nevertheless grant them as frequently as other firms.<sup>284</sup> This pattern suggests in turn that tax treatment is in fact not determinative with respect to the use of stock options as a form of managerial remuneration.

Other aspects of U.S. tax policy illustrate that tax rules may not have the sort of impact on executive compensation that might be anticipated. In 1993, President Clinton, fulfilling a campaign pledge to halt "excessive executive pay," initiated changes to tax law that disallowed tax deductibility of executive pay exceeding \$1 million annually, unless the additional compensation was "performance related."<sup>285</sup> Data collected in subsequent years indicates that this change did very little to slow increases in executive pay and only fostered a minor substitution of performance-related pay for salary.<sup>286</sup> This pattern, together with the evidence on the deductibility of stock options, suggests that corporate tax policies may in fact not have a significant impact on globalization trends in executive compensation.

### B. Labor Law

Compensation experts warn that U.S.-style incentive-oriented managerial compensation could conflict with national labor legislation. Several countries in

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stock options that qualify as "ISOs" (incentive stock options). See MICHAEL S. SIRKIN & LAWRENCE K. CAGNEY, EXECUTIVE COMPENSATION §5.02[2] (2000). On the implications of this, see Saul Levmore, *Puzzling Stock Options and Compensation Norms*, 149 U. PA. L. REV. 1901, 1912 (2001).

282. Wolfgang Bernhardt, *Stock Options For or Against Shareholder Value? New Compensation Plans for Top Management and the Interests of Shareholders*, 7 CORP. GOVERNANCE: INT'L REV. 123, 129 (1999); Diane Francis, *The Scourge of Stock Options*, NAT'L POST, May 24, 2001, at C3; Johnston, *supra* note 6; Zukis, *supra* note 278.

283. Conyon & Murphy, *supra* note 19, at 665; see also Kevin J. Murphy, *Explaining Executive Compensation: Managerial Power Versus the Perceived Cost of Stock Options*, 69 U. CHI. L. REV. 847, 866-67 (2003).

284. Hall & Liebman, *supra* note 281, at 29.

285. Kevin J. Murphy, *Politics, Economics, and Executive Compensation*, 63 U. CIN. L. REV. 713, 714, 738 (1995).

286. Hall & Liebman, *supra* note 24, at 34-36, 42; cf. Alarie, *supra* note 217, at 66-68.

Europe and Latin America have laws regarding “acquired rights” that might, over time, transform compensation conditioned on performance into entitlements.<sup>287</sup> Since companies will understandably be reluctant to risk this transformation, acquired rights laws could deter a move towards American-style executive compensation packages. Indeed, according to a Towers Perrin study of stock options, these rules have had a “very important” effect on the awarding of such compensation in France and Mexico.<sup>288</sup>

The impact of “acquired rights” legislation should not, however, be overestimated. While share option plans might constitute an “entitlement” under acquired rights legislation in some countries, they may not in others.<sup>289</sup> Also, companies’ experience in Brazil suggests that, even if acquired rights regulations do apply to incentive-oriented pay arrangements, the practical impact will not necessarily be significant.<sup>290</sup> During the 1990s, performance-based pay became substantially more popular as Brazilian subsidiaries of major multinationals offered lucrative bonus schemes to lure managerial talent away from domestic companies. In response to this trend, and in direct contradiction of existing legislation, Brazil’s Labor Ministry expressly authorized domestic companies to use variable pay based on corporate performance.<sup>291</sup>

## VII. “SOFT LAW”

“Soft law” is an increasingly important determinant of international corporate behavior.<sup>292</sup> For present purposes, we define the term as corporate rules and guidelines promulgated by private organizations rather than by legislatures, government regulators, or judges.<sup>293</sup> Under this definition, the fact that those formulating the relevant standards act pursuant to a statutory mandate does not affect the regulations’ “soft law” status. Hence, in an American context, accounting standards developed by the privately organized Financial Accounting Standards Board (FASB) qualify as “soft law,” even though the Board exercises powers delegated to it by the SEC.<sup>294</sup> Similarly, listing rules governing the privately owned New York Stock Exchange (NYSE) and

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287. Gross & Wingerup, *supra* note 11, at 29; Tara Parker-Pope, *Culture Clash: Do U.S.-Style Stock Compensation Plans Make Sense in Other Countries?*, WALL ST. J., Apr. 12, 1995, at R7; Sven Tischendorf, *Planning for Stock Options in Germany*, INT’L. TAX REV., Dec. 1998-Jan. 1999, at 39.

288. TOWERS PERRIN, *supra* note 32, at 10.

289. Jeffrey R. Gates & David E. Reid, *Translating Your ESOP Abroad*, FIN. EXECUTIVE, July 1994, at 26.

290. Tom Leander, *Latin Comp Joins the Fray*, GLOBAL FIN., Aug. 1998, at 27.

291. In the Towers Perrin study of stock options, “acquired rights” legislation was found to be “somewhat important” in Brazil. TOWERS PERRIN, *supra* note 32, at 10. There were six other countries where the situation was found to be the same. *Id.*

292. Branson, *supra* note 177, at 670-71.

293. *Id.* (providing other definitions).

294. For more background on the FASB and its relationship with the SEC, see CHEFFINS, *supra* note 17, at 376-77, 410-11.

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NASDAQ are “soft law.” Even though the SEC has the power to veto proposed regulations and amend or delete existing rules, the NYSE and NASDAQ formulate and enforce the relevant standards.<sup>295</sup>

“Soft law” touches on various executive pay issues. One is shareholder voting. To use an American example, the listing rules of the NYSE and NASDAQ stipulate that, subject to a few exceptions, listed companies must obtain shareholder approval before introducing a stock option plan.<sup>296</sup> On the foreign side, the Australian Stock Exchange’s listing rules provide that, under an employee incentive scheme, shareholders must vote on the issuance of securities to directors.<sup>297</sup> The stock market rules in New Zealand, Hong Kong, and Singapore provide for similar regulations.<sup>298</sup>

“Soft law” can also address disclosure issues. Britain was a “first mover” in this regard, as disclosure of executive pay was dealt with in considerable detail in London Stock Exchange listing rules beginning in the mid-1990s<sup>299</sup> until the relevant rules were shifted to legislation in 2002.<sup>300</sup> Similarly, Germany now stands out as a country in which “soft law” has strongly influenced disclosure regulation.<sup>301</sup> Under German corporate legislation, companies are not obliged to divulge remuneration arrangements for individual corporate officials.<sup>302</sup> In 2002, however, the federal legislature amended the German Stock Corporation Act to compel publicly traded companies to disclose whether their corporate governance practices complied with a code drafted by a business-led committee.<sup>303</sup> Changes made to the code in 2003 require listed companies to publish a detailed breakdown of the pay arrangements of each director serving

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295. Securities Exchange Act of 1934, 15 U.S.C. §78s(b)-(c) (2004). For discussion, see Roberta S. Karmel, *The Future of Corporate Governance Listing Requirements*, 54 SMU L. REV. 325, 339 (2001).

296. A 2003 Securities and Exchange Commission ruling approving changes to the NYSE and NASDAQ listing rules narrowed considerably the range of exceptions. For background, see Self-Regulatory Organizations, Exchange Act Release, No. 34-48108, 2003 LEXIS SEC 1540 (June 30, 2003).

297. Australian Stock Exchange Listing Rules, ¶10.14.

298. See Jonathan Lemberg & Kathleen Keeler, *Equity Compensation: Bringing U.S.-Style Stock Option Plans to Asia*, INT’L FIN L. REV., Oct. 2001, at Supplement 33, 36; *Taking Stock of Business*, N.Z. HERALD, Jan. 22, 2000, available at 2000 WL 7609569.

299. For an overview, see RICHARD SMERDON, A PRACTICAL GUIDE TO CORPORATE GOVERNANCE 66-69 (Sweet & Maxwell, 1998); Brian R. Cheffins, *Corporate Governance in the United Kingdom: Lessons for Canada*, 28 CAN. BUS. L.J. 69, 83 (1997) [hereinafter Cheffins, *Corporate*].

300. The self-regulatory orientation of disclosure regulation was in fact displaced to a significant extent in 2000 when the Financial Services Authority, a government regulator, replaced the Stock Exchange as the administrator of the listing rules. For further details, see *infra* notes 318-320 and accompanying text.

301. It also appears that listing rules are being used to bolster executive pay disclosure in India. RAMAIIYA, 15th ed., *supra* note 194, at 2747.

302. See *supra* notes 253-254 and related discussion.

303. On the commission and the legislative backing it has, see Commission of the German Corporate Governance Code, *German Corporate Governance Code*, available at <http://www.corporate-governance-code.de/index-e.html>; Theodor Baums, *Company Law Reform in Germany*, 3 J. CORP. L. STUD. 181, 182-83 (2003); Hugh Williamson, *Germany Faces More Corporate Reform*, FIN. TIMES, July 7, 2003, at FT Fund Management 7.

on the management board or explain why such disclosure has not been made.<sup>304</sup> Observers anticipate that large companies will not want to justify opacity, and will instead disclose executive pay in accordance with the precepts of the code.<sup>305</sup>

“Soft law” accounting standards can also govern disclosure of information on managerial compensation and thereby affect how companies deal with remuneration. For instance, some attribute the popularity of stock options in the United States to their treatment under FASB guidelines covering the income statement.<sup>306</sup> According to FASB standards, a corporation awarding stock options with no attached performance conditions does not have to set the “cost” against profits,<sup>307</sup> though the information does have to be disclosed in footnotes to the accounts. Since granting stock options to executives does not affect the “bottom line,” U.S. accounting rules allegedly create a bias in favor of this form of compensation, at least where the options are of the “plain vanilla” variety.<sup>308</sup> Amid scandal-induced criticism of alleged abuses of incentive-oriented executive compensation, the FASB launched a debate in 2002 over accounting for stock-based remuneration.<sup>309</sup> At present, it is unclear whether America’s publicly traded companies will ultimately be compelled to “expense” options in their financial statements.<sup>310</sup>

While FASB guidelines might affect to some degree the form of America’s

304. Bertrand Benoit, *New Rules Put German Pay Out in the Open*, FIN. TIMES, May 23, 2003, at 28.

305. *Id.*

306. For examples, see Bebchuk et al., *supra* note 15, at 45. In Britain, the equivalent document is known as the profit-and-loss account. See *The Party’s Over*, ECONOMIST, Jan. 27, 2001, at Survey of Corporate Finance 16.

307. See SIRKIN & CAGNEY, *supra* note 248, § 5.02[5]; Susan J. Stabile, *Motivating Executives: Does Performance-Based Compensation Positively Affect Managerial Performance?*, 2 U. PA. J. LAB. & EMP. L. 227, 276-78 (2001). Even with plain vanilla options, a company must deduct the cost from profits if the options are “repriced”; *FASB Offers More Guidance on Stock Options*, J. ACCOUNT., July 2000, at 18; Richard Waters & Paul Abrahams, *Raising Stock from the Deep*, FIN. TIMES, Oct. 21, 2000, at 17.

308. Murphy, *supra* note 11, at 2514-15; Gretchen Morrison, *Investors May Now Eye Costs of Stock Options*, N.Y. TIMES, Aug. 29, 2000, at C1; David Leonhardt, *Will Today’s Huge Rewards Devour Tomorrow’s Earnings?*, N.Y. TIMES, Apr. 2, 2000, § 3, at 1.

309. On the launching of the debate by the FASB and the reasons for it, see ACCOUNTING FOR STOCK-BASED COMPENSATION: A COMPARISON OF FASB STATEMENT NO., 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, AND ITS RELATED INTERPRETATIONS, AND IASB PROPOSED IFRS, SHARE-BASED PAYMENT, Financial Accounting Series, No. 1102-001 13-14 (Financial Accounting Standards Board, Nov. 18, 2002); Andrew Hill and Peronet Despeignes, *Balancing Options*, FIN. TIMES, Apr. 19, 2002, at 18; Greg Hitt and Jacob M. Schlesinger, *Perk Police: Stock Options Come Under Fire in Wake of Enron’s Collapse*, WALL ST. J., Mar. 26, 2002, at A1. If this change occurs, it could help bring about a convergence in international accounting standards for stock options. Andrew Parker and Andrew Hill, *Standard Setters Are Targeting Stock Options Again*, FIN. TIMES, Nov. 11, 2002, at 11.

310. On the status of the debate, see Financial Accounting Standards Board, Project Updates: Stock Based Compensation (last updated: August 22, 2003), available at [http://www.fasb.org/project/stock-based\\_comp.shtml](http://www.fasb.org/project/stock-based_comp.shtml). Even without reform, a growing number of U.S. companies have voluntarily begun to treat stock options as an expense: Robert W. Hamilton, *The Crisis in Corporate Governance: 2002 Style*, 40 HOUS. L. REV. 1, 72 (2003).

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executive remuneration,<sup>311</sup> they do not entirely explain why stock options are more popular in the United States than they are in other countries. The promulgation of accounting standards is not universal—Germany only established an independent standard setter in 1998<sup>312</sup>—and, where standards are well-established, they commonly do not include guidance on the treatment of share-based remuneration.<sup>313</sup> The result is that, just as with FASB rules, the granting of stock options does not affect the corporate “bottom line.”<sup>314</sup> As is the case with the United States, reform is on the policy agenda.<sup>315</sup> Still, for now, the key point is that, since the accounting bias in favor of stock options currently exists outside the United States, other factors must account for the unique popularity of this form of compensation among America’s publicly traded corporations.

Soft law, in addition to addressing shareholder voting and disclosure, can directly set down guidelines for the determination of executive pay. Over the past few years, various “blue ribbon” committees around the world (often staffed by business leaders and stock market officials) have drafted codes so as to provide publicly traded corporations with guidance on a range of corporate governance issues.<sup>316</sup> These committees often address the setting of executive pay.<sup>317</sup> A path-breaking forerunner on this count was a corporate governance code set out in the London Stock Exchange’s listing rules. Beginning in 1995,

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311. For analysis see Bebchuk et al., *supra* note 15, at 810-11; Core et al., *supra* note 102, at 43.

312. *Reform in Germany*, ACCOUNTANT, July 21, 2000, at 17.

313. Kimberley Crook, *Accounting for Share-based Remuneration 2* (unpublished working paper, on file with the authors, 2003); ACCOUNTING STANDARDS BOARD (U.K.), *SHARE-BASED PAYMENT APPENDIX E*, (2000) (discussing the accounting treatment of the issuance of shares in return for services in countries represented in the G4 +1, an accounting think-tank composed of standard-setters from Australia, New Zealand, Canada, Britain, and the United States).

314. *Reform in Germany*, *supra* note 312 (discussing Germany); Thorold Barker & Michael Peel, *Companies Given No Choice on Revealing Share Options*, FIN. TIMES, July 21, 2000, at 27 (UK); Mitchell, *supra* note 13 (Australia); Ron Paterson, *Grasping the Nettle*, ACCOUNTANCY (UK), Sept. 5, 2000, at 102 (UK); Phillip Day, *Stock Options in Asia Face Change*, WALL ST. J., Aug. 6, 2002, at C16. In Canada, by virtue of changes made to accounting standards in 2002, companies must disclose the value of options granted in the notes to their financial statements. On the rule, and its impact, see Christine Wiedman et al., *Accounting for Stock-Based Compensation: The Devil is in the Details*, IVEY BUS. J., July/Aug. 2003, at 1.

315. The deliberations of the International Accounting Standards Board (IASB), a private group based in London, constitute the focal point for discussion. On the IASB’s deliberations, see Crook, *Accounting*, *supra* note 313, at 7-10. In Canada, however, accounting regulators have already announced that Canadian accounting standards will be amended to compel companies to record stock options as a business expense. See Janet McFarland, *Accounting Board Dims Stock Options’ Appeal*, GLOBE & MAIL, March 26, 2003, at B2; Exposure Draft, STOCK BASED COMPENSATION AND OTHER STOCK BASED PAYMENTS (Accounting Standards Board, December 2002), available at <http://www.cica.ca/ed>.

316. On the countries in which a governance code has been issued, and on those responsible for such activity, see Brian R. Cheffins, *Corporate Governance Reform: Britain as an Exporter*, 8 HUME PAPERS ON PUB. POL’Y (#1) 10, 13-14 (2000) [hereinafter Cheffins, *Reform*]; David Noburn et al., *International Corporate Governance Reform*, 12 EUR. BUS. J. 116 (2000).

317. Voluntary guidelines issued by institutional investors on executive pay constitute another example of “soft law” aimed at the setting of managerial remuneration. On the role they play in the United States and Britain, see Cheffins & Thomas, *supra* note 122, at 313.



the code instructed listed companies to take into consideration the “wider scene” (such as pay and employment conditions elsewhere in the business), to avoid paying more than necessary when hiring talented executives, and to follow detailed guidelines in designing performance-related compensation.<sup>318</sup> In 2000, a government regulator (the Financial Services Authority, or “FSA”) was vested with authority to administer the listing rules for companies quoted on the London Stock Exchange.<sup>319</sup> Though no longer constituting “soft law,” the current listing rules continue to contain a modified version of code principles on executive pay first introduced in 1995.<sup>320</sup>

Listed companies in Britain have never been obliged to comply with corporate governance codes offering guidance on how to set executive pay. Instead, they have only been required to disclose whether they have conformed with the relevant standards.<sup>321</sup> Nevertheless, compliance with the standards has been substantial.<sup>322</sup> Hence, it is sensible to infer that Britain’s best practice guidelines on executive pay have influenced the configuration of managerial remuneration,<sup>323</sup> even if they were originally developed as “soft law.”

The British example notwithstanding, it is unclear whether corporate governance codes offering guidance on the setting of managerial remuneration will have a significant impact elsewhere. In some jurisdictions, the relevant document receives little or no backing from securities regulations or stock market listing rules, thus rendering compliance purely voluntary.<sup>324</sup> In addition, the guidelines offered are typically less detailed than those which were introduced in Britain, with a standard format being a few sentences stressing the importance of linking pay to performance.<sup>325</sup> “Soft law” guidelines framed in

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318. SMERDON, *supra* note 299, at 72-75.

319. On the Financial Services Authority’s status as the administrator of the Listing Rules, see OFFICIAL LISTING OF SECURITIES (CHANGE OF COMPETENT AUTHORITY) REGULATIONS 2000, S.I. 2000/968.

320. See Fin. Servs. Auth., Listing Rules, Combined Code on Corporate Governance, Code of Best Practice, § 1.B, Sched. A, available at [http://www.fsa.gov.uk/pubs/ukla/tr\\_comcode3.pdf](http://www.fsa.gov.uk/pubs/ukla/tr_comcode3.pdf) (last visited Dec. 7, 2004).

321. SMERDON, *supra* note 299, at 67; Fin. Servs. Auth., Listing Rules, ¶ 12.43A(b); Cheffins, *Corporate*, *supra* note 299, at 82-83. Those failing to divulge departures from the relevant guidelines have been subject to various possible sanctions, including delisting. Cheffins, *Corporate*, *supra* note 299, at 83; Fin. Servs. Auth., Listing Rules, ¶ 1.9.

322. See, e.g., HAMPPEL REPORT, *supra* note 265, ¶ 1.10; COMPANY LAW REVIEW STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: DEVELOPING THE FRAMEWORK ¶ 3.129 (2000).

323. HAMPPEL REPORT, *supra* note 265, ¶ 1.9 (discussing disclosure); PENSIONS & INVESTMENT RESEARCH CONSULTANTS LTD., CORPORATE GOVERNANCE 2000 25 (2000) (discussing the length of directors’ service contracts, dealt with in the Combined Code, ¶ B.1.7).

324. For a breakdown of countries where the corporate governance code is merely voluntary as compared with those where there is regulatory backing, see Cheffins, *Reform*, *supra* note 316, at 14; Holly J. Gregory, Overview of Corporate Governance Guidelines & Codes of Best Practice in Developing & Emerging Markets 3 (1999) (unpublished working paper on file with authors).

325. See, e.g., GERMAN CORPORATE GOVERNANCE CODE (as amended on May 21, 2003), ¶ 4.2.3, available at [http://www.corporate-governance-code.de/eng/download/DCG\\_K\\_E200305.pdf](http://www.corporate-governance-code.de/eng/download/DCG_K_E200305.pdf) (last visited

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this sort of general way may well lack the sort of clout required to significantly affect trends in executive pay.

### VIII. CULTURE

“Culture” is difficult to define with precision,<sup>326</sup> and it may constitute nothing more than a country’s particular legal and financial arrangements.<sup>327</sup> Still, experts on managerial compensation frequently draw upon the concept to explain why remuneration arrangements differ considerably across countries.<sup>328</sup> Thus, culture—which we will define as a society’s shared values, understandings, and assumptions<sup>329</sup>—merits examination as a variable potentially affecting the globalization of executive pay.

It has been said that foreign cultural sensitivities toward lavish managerial remuneration might help to “prevent the wretched excess of . . . American-size pay packages.”<sup>330</sup> Underlying this view is the assumption that the United States is highly “tolerant of income inequality, especially if the inequality is driven by differences in effort, talent or entrepreneurial risk taking.”<sup>331</sup> On the other hand, Americans do worry about the fairness of their market-based system; according to one observer, criticizing executive compensation is “something of a national pastime.”<sup>332</sup> Ultimately, though, “Americans suffer neither envy nor egalitarian yearnings when gazing at the fortunes of their business leaders.”<sup>333</sup> This, in turn,

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month date, year); COMMITTEE ON CORPORATE GOVERNANCE, CODE OF BEST PRACTICE FOR CORPORATE GOVERNANCE ¶ 9.1 (1999) (Korea), available at [http://www.ecgi.org/codes/country\\_documents/korea/code\\_korea.pdf](http://www.ecgi.org/codes/country_documents/korea/code_korea.pdf) (last visited month date, year), and related discussion; COMMITTEE FOR THE CORPORATE GOVERNANCE OF LISTED COMPANIES, CORPORATE GOVERNANCE CODE ¶ 8.2 (2002) (Italy), available at [http://www.ecgi.org/codes/country\\_documents/italy/code\\_it\\_jul2002\\_eng.pdf](http://www.ecgi.org/codes/country_documents/italy/code_it_jul2002_eng.pdf); Harilaos V. Mertzanis, *Principles of Corporate Governance in Greece*, 9 CORP. GOVERNANCE: INT’L REV. 89, 97 (2001) (discussing a report issued in 1999).

326. Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147, 166 (2001).

327. *Back on Top?*, ECONOMIST, Sept. 16, 1995, at Survey S3.

328. Sydney R. Robertson, *Establishing Global Compensation Strategies*, in COMPENSATION HANDBOOK, *supra* note 18, at 603, 606-7; Mark J. Roe, *Can Culture Constrain the Economic Model of Corporate Law?*, 69 U. CHI. L. REV. 1251, 1261 (2002).

329. DERESKY, *supra* note 180, at 105.

330. *Damn Yankees*, *supra* note 13; see also Herbert A. Henzler, *The New Era of Eurocapitalism*, HARV. BUS. REV., July-Aug. 1992, at 57, 60; Johnston, *supra* note 6; Richard Cohen, *Jack Welch and “Class Envy”*, WASH. POST, Sept. 17, 2002, at A21 (arguing that more “class envy” in the United States might “act as a brake on the whole Greed is Good movement”).

331. Conyon & Murphy, *supra* note 19, at n.667.

332. Susan J. Stabile, *Viewing Corporate Executive Compensation Through a Partnership Lens: A Tool to Focus Reform*, 35 WAKE FOREST L. REV. 153, 153 (2000). On perceptions of the market economy in the United States and how they relate to executive pay, see *Wallowing in Wages*, ECONOMIST, Apr. 6, 2002, at 65.

333. *Wallowing in Wages*, *supra* note 115, at 66. For more negative characterizations of American attitudes, see Gay, *supra* note 66 (“swashbuckling culture”); Simon Caulkin, *Harder and Harder to Swallow*, OBSERVER, May 4, 2003, at 21 (“(b)oardroom excess is as American as apple pie and violence”). Cf. Roe, *supra* note 328, at 1261 (arguing that Americans envy but do not hate the rich).

allegedly provides a hospitable platform for lucrative performance-oriented executive pay.<sup>334</sup>

Matters supposedly are much different in other countries. A strong egalitarian impulse, it is said, may create distaste for hierarchy and enforce a presumption that “enrichment of an individual on the backs of the workers is . . . exploitation.”<sup>335</sup> To illustrate, people in continental European countries are said to be acutely sensitive to pay differentials based on rank,<sup>336</sup> and are reputedly uneasy about conspicuous displays of wealth.<sup>337</sup> Similarly, the Japanese allegedly subscribe to the adage that “when in public, wear cotton. If you must wear silk, wear it at home.”<sup>338</sup>

Strikingly, even in English-speaking countries reputed to share a common business culture with the United States, this account of cultural aversion to high executive pay is invoked.<sup>339</sup> For instance, one commentator has noted that “[t]he British have always been suspicious of wealth, particularly of the rich who made their money in the marketplace.”<sup>340</sup> This bias purportedly explains why executive pay arrangements in Britain are not as lucrative or performance-oriented as in the United States.<sup>341</sup> The discrepancy in managerial remuneration between the United States and Canada has also been ascribed to “fundamental cultural differences,”<sup>342</sup> namely Canada’s “gentler society”<sup>343</sup> and “stubborn egalitarian streak.”<sup>344</sup> Experts on Australian executive compensation have spoken similarly about the country’s comparatively modest managerial pay, saying that Australians are uncomfortable with “tall poppies” who stand out

334. Cox, *supra* note 4; Michael Crawford, *Peanuts for Elephants*, CAN. BUS., July 1994, at 16; Morais, et al., *supra* note 66; Maria Slade, *NZ Executives Pay Third World Salaries*, INDEP. BUS. WEEKLY, Sept. 26, 1997, at 23. See also David Leonhardt, *Executive Pay Drops Off the Political Radar*, N.Y. TIMES, Apr. 16, 2000, at Week in Review 5; Murphy, *Explaining*, *supra* note 283, 855-56 (drawing attention to a general lack of hostility towards generous executive pay in the United States).

335. Fung, *supra* note 81, at 39; see also Gross & Wingerup, *supra* note 11, at 27; Woodruff, *Across Europe, CEOs Get No Respect*, *supra* note 274; Birgit Gugath & Neal E. Boudette, *Angry German Public Lashes Out at CEO Pay*, WALL ST. J. EUR., Aug. 6, 2002, at A6.

336. David Reilly et al., *Europe’s Low Pay-Rage Threshold*, WALL ST. J., Sept. 19, 2003, at A8.

337. See, e.g., Tully, *supra* note 58.

338. Berger, *supra* note 90.

339. On business culture typologies, see DERESKY, *supra* note 180, at 117-18.

340. William Rees-Mogg, *The Fat Cat is the Pensioner’s Friend*, TIMES, June 3, 1996, at 20; see also Parker-Pope, *supra* note 65; Therese Raphael, *Hunting Fat Cats, Shooting Wild*, WALL ST. J. EUR., June 26, 2002, at A9.

341. Conyon & Murphy, *supra* note 19, at nn.667-68; Martin Vander Weyer, *Too Much Cream*, INDEP., Aug. 16, 1998, at 16; but cf. Martin Dickson, *Alice in Wonderland World of Executive Pay*, FIN. TIMES, June 22/23, 2002, at 15 (arguing that disclosure of executive compensation in Britain is highly complex because “the knee-jerk UK antipathy to high pay” leaves companies wary about revealing how much top managers stand to earn).

342. Crawford, *supra* note 334.

343. Gay, *supra* note 66.

344. Deirdre McMurdy, *Taking Stock of Options*, MACLEAN’S, Apr. 28, 1997, at 49; see also Paul Waldie, *Canadian CEOs in Middle of Pay Pack*, GLOBE & MAIL, Apr. 26, 1999, at B6.

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economically.<sup>345</sup>

If culture is as important as the received wisdom suggests, it could potentially deter convergence of executive pay along U.S. lines. Remuneration consultants report that in continental Europe and Japan, executives find distasteful the massive pay-outs American companies deliver to high-flying managers.<sup>346</sup> Allegedly, “the greed factor is lower than in the US,”<sup>347</sup> manifested in a belief that those who run companies should not seek inordinately large managerial compensation.<sup>348</sup> To the extent that executive self-restraint is firmly entrenched, it will act as a brake on a shift towards U.S.-style executive pay.

A sense that companies serve a range of “social” objectives rather than simply existing to maximize shareholder return could also impede a transition towards the U.S. approach to executive pay.<sup>349</sup> In continental Europe and the market-oriented economies of Asia, managers are often characterized as trustees acting on behalf of a corporate community that encompasses constituencies other than profit-oriented investors.<sup>350</sup> An American-style “incentivized” managerial services contract will give management a financial inducement to promote shareholder interests potentially at the expense of other “stakeholders.” Correspondingly, heavy use of variable pay could create considerable anxiety outside the shareholder class.<sup>351</sup> So long as the “public service” notion of the company continues to be taken seriously, this apprehension could inhibit the adoption of the U.S. pay paradigm.<sup>352</sup>

Culture could also serve to check the Americanization of executive pay by engendering societal resistance stemming from what Bebchuk, Fried, and Walker refer to as the “outrage” constraint.<sup>353</sup> If executive pay packages become highly lucrative, the violation of equity norms within society might yield a “backlash.”<sup>354</sup> This sort of societal “backlash” could, in turn, affect executive pay by activating corporate self-discipline.<sup>355</sup> More precisely, since directors

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345. Slade, *supra* note 334; see also Florence Chong, *Salary Secrets: What Companies Have to Fear*, BUS. REV. WKLY., June 5, 1987, at 50; Julie McBeth, *Who Pays the Top Salaries*, BUS. REV. WKLY., Nov. 25, 1988, at 60.

346. Lublin, *supra* note 154; Johnston, *supra* note 6.

347. Tully, *supra* note 58 (internal quotations omitted).

348. Gross & Wingerup, *supra* note 11, at 27; *Damn Yankees*, *supra* note 13; Burgess, *supra* note 64.

349. Blackledge, *supra* note 8; Burgess, *supra* note 64; Mazur, *supra* note 82.

350. See, e.g., Ronald Dore, *The Asian Form of Capitalism*, in P.H. Admiral ed., *THE CORPORATE TRIANGLE: THE STRUCTURE AND PERFORMANCE OF CORPORATE SYSTEMS IN A GLOBAL ECONOMY* 35, 42-43, 47 (Blackwell Publishers, 1997); Bennett, *supra* note 16; Henzler, *supra* note 330, at 60-61.

351. Cheffins, *Metamorphosis*, *supra* note 10, at 515-16.

352. Burgess, *supra* note 64; Cheffins, *Metamorphosis*, *supra* note 10, at 514-16 (focusing on employees in German companies).

353. Bebchuk et al., *supra* note 15, at 756, 786-87.

354. Brown, *supra* note 183; Romesh Ratnesar, *Get Rich Quick*, TIME, May 8, 2000, at B7; *Those Egalitarian Swedes*, ECONOMIST, June 3, 2000, at 49.

355. CHEFFINS, *supra* note 17, at 699.

and executives could suffer social and reputational losses for violating the outrage constraint, they might shy away from being associated with highly lucrative service contracts.<sup>356</sup> As Bebchuk *et al.* say, “[d]irectors w[ill] be loath to approve a compensation plan that would embarrass them” and “the same fear of embarrassment . . . might also affect managers directly and thereby discourage them from seeking such a package.”<sup>357</sup> In extreme cases, directors may even feel compelled by shareholder criticism or public outrage to orchestrate the departure of an executive caught in the middle of a controversy over executive pay.<sup>358</sup>

Breach of the “outrage” constraint might also prompt government-instigated reform. President Clinton’s introduction of a deductibility exclusion for managerial remuneration exceeding \$1 million demonstrated that public unease over managerial remuneration can spark regulation.<sup>359</sup> Likewise, in the mid-1990s, a British trade organization representing the interests of the U.K. business community felt compelled by growing disquiet over executive pay to set up a committee (chaired by Sir Richard Greenbury) to study the issue.<sup>360</sup> The ensuing report prompted the London Stock Exchange to deal with executive pay issues by amending the corporate governance code contained in its listing rules.<sup>361</sup> Neither tax reform in the United States nor the work of Britain’s Greenbury Committee in fact fully satisfied the critics of executive pay in either country.<sup>362</sup> Still, both incidents point to how violation of the “outrage constraint” can lead to reform designed to correct controversial remuneration practices.

While cultural values conceivably might hinder the Americanization of executive pay, these values can also evolve in ways that will actually increase receptivity to U.S.-style change. The experience in Britain is illustrative. During the 1970s, British executives were paid less than their counterparts in all other major industrial countries.<sup>363</sup> Moreover, at the time, British managerial culture

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356. Bebchuk *et al.*, *supra* note 15, at 787-88; *see also* Alex Brummer, *Failing Brakes on Boardroom Pay*, *GUARDIAN*, June 1, 1996, at 38.

357. Bebchuk *et al.*, *supra* note 15, at 787. For an example of this process, *see* Parker-Pope, *supra* note 65.

358. This appears to be what happened to Dick Grasso, who resigned as chief executive of the New York Stock Exchange after a controversy surrounding his compensation package. *See* Adrian Michaels, *The Grasso Resignation: Largest Groups Rein in Excessive Deals*, *FIN. TIMES*, Sept. 19, 2003, at 32. In a similar vein, terminated CEOs may find that public disclosure of a lucrative severance package can cause adverse publicity which leads directors to cut back on these payments. *See* Vauhini Vara, *Hard Landing for Europe’s Ex-CEOs*, *WALL ST. J.*, Sept. 5, 2003, at A7.

359. *See* Murphy, *supra* note 285.

360. CHEFFINS, *supra* note 17, at 655-56.

361. *Id.* at 656.

362. *See, e.g.*, Graef Crystal, *Need a Good Laugh? Look at Caps on Executive Pay*, *L.A. TIMES*, May 21, 1995, at D2 (on the US); *How Greenbury Has Boosted Executive Access*, *supra* note 264 (on the UK).

363. *International Executive Compensation*, *supra* note 63; Hugh Parker, *The Effective Executive: What is He Worth?*, *MCKINSEY Q.*, Winter 1976, at 22, 27-28.

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was suffused with highly muted reward preferences similar to those prevailing in egalitarian West Germany.<sup>364</sup>

Matters changed substantially within a fairly brief period of time, however. Throughout the 1980s, a Conservative administration imbued with a free-market ideology governed Britain. The effect on executive pay was profound.<sup>365</sup> In 1988, *Fortune* magazine declared that “[a] pay revolution is shaking Britain. Prime Minister Margaret Thatcher’s bracing brand of capitalism brought not just tax cuts and high profits but also a profound change in public attitudes. Big pay packages are no longer frowned upon.”<sup>366</sup> Coincident with this shift in attitude was a dramatic change in managerial compensation. Between 1979 (when the Conservatives took office) and 1994, the gross pay of chief executives in larger U.K. public companies rose nearly 600%.<sup>367</sup> By the mid-1990s, British CEOs were no longer remuneration also-rans, but instead counted among the best paid executives in the industrialized world.<sup>368</sup>

Outside Britain, there are signs that the cultural environment is becoming more hospitable for U.S.-style executive pay. An expert on Canadian managerial compensation observed in 2001 that the market for executive talent was being influenced ever more strongly by American trends, thus “imposing the US social order on good old Canada.”<sup>369</sup> Australia allegedly is engaged in a “slide towards US-style inequality” and significant increases in pay awarded to the country’s executives have been cited as a “depressing milestone” marking this trend.<sup>370</sup> Moreover, speculation has it that Germans, both inside and outside the boardroom, are adopting a more tolerant attitude towards wealth accumulation.<sup>371</sup> Thus, while social values may continue to influence the setting of executive pay, shifting cultural norms could actually function to bring other countries closer to U.S.-style executive remuneration.

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364. CHRISTEL LANE, *MANAGEMENT AND LABOUR IN EUROPE: THE INDUSTRIAL ENTERPRISE IN GERMANY, BRITAIN AND EUROPE* 131-32 (Edward Elgar, 1989); Andreas Budde et al., *Corporate Goals, Managerial Objectives, and Organizational Structures in British and West German Companies*, 3 *ORG. STUD.* 1 (1982).

365. Martin Conyon & Robert Singh, *Taking Care of Business: The Politics of Executive Pay in the United Kingdom*, 11 *CONTEMP. BRIT. HIST.* 1, 8 (1997).

366. Tully, *supra* note 58. On how matters progressed in the decade which followed, see Vander Weyer, *supra* note 341.

367. David Goodhart, *In Search of Wages that Work*, *FIN. TIMES*, June 27, 1994, at 14. See also Conyon & Singh, *supra* note 365, at 7.

368. Abowd & Kaplan, *supra* note 52, at 146, Table 1. A possibility is that the 1970s were exceptional and the pay surge in the 1980s and 1990s brought matters back into line with longer-term trends. Matthews, *supra* note 134.

369. Silcoff, *supra* note 13.

370. Mitchell, *supra* note 13.

371. Cheffins, *Metamorphosis*, *supra* note 10, at 497-539; Wolfgang Münchau, *Few Signs of the ‘Fat Cat’*, *FIN. TIMES*, May 29, 1996, at Survey 7.

## IX. CONCLUSION

American chief executives are the most highly paid in the world, and not surprisingly, CEO pay has proved controversial in the United States.<sup>372</sup> Similarly, British managers are well paid by global standards and executive compensation has been an intensely debated topic.<sup>373</sup> Managerial remuneration has also attracted attention in Canada and Australia.<sup>374</sup> Elsewhere, though, debate about the topic has typically only flared up periodically.<sup>375</sup>

Matters, however, may soon change. As this Article has described, there is evidence that a “global shakeup in executive comp” could be occurring. To reiterate, market dynamics that might foster such a shakeup include wider dispersion of share ownership, increased cross-border hiring of executives, growing international M & A activity, and the expansion of business activity by multinationals. Gauging how influential these factors will be in practice is difficult.<sup>376</sup> Still, if their impact is substantial and a strong Americanization trend develops, the changes likely will prompt vigorous debate in the affected countries.

The controversy which would ensue if U.S.-style executive pay becomes more prominent would place policymakers under pressure to confront the situation. Views on the appropriate response would no doubt differ. Those supportive of a shift in an American direction might assert that domestic companies are justified in changing policy since talented nationals would be less likely to emigrate in pursuit of higher pay. They also might cite America’s successful corporate economy as testimony to the effectiveness of performance-oriented compensation. Underlying this contention would likely be the premise that the introduction of a highly “incentivized” approach to remuneration would provide a valuable boost to companies that had previously treated shareholders as “second class citizens.”<sup>377</sup>

On the other hand, after the corporate governance scandals which afflicted

372. See *supra* note 12 and accompanying text.

373. See *infra* note 387 and accompanying text.

374. See, e.g., Francis, *supra* note 282; Deirdre McMurdy, *The Polarized Economy*, MACLEAN’S, Oct. 7, 1996, at 49; Rod McQueen, *Executive Payoffs are out of Control*, NAT’L POST (Canada), Apr. 3, 2000, at C3 (on Canadian executives); S. Karene Witcher, *Big CEO Pay as Lure Riles Some Australians*, GLOBE & MAIL (Toronto), July 31, 1998, at B6.

375. Ferrarini et al., *supra* note 89, at 4 (saying that the controversy has been restricted to countries with dispersed share ownership but noting that there was concern about executive pay in France); Thomas J. André, Jr., *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69, 159-61 (1998); Gail Edmondson, *France: A CEO’s Pay Shouldn’t be a Secret*, BUS. WEEK, Aug. 9, 1999, at 24 (saying that with respect to executive pay French society had yet “to confront its schizophrenic feelings about wealth”).

376. See *supra* notes 187-89 and accompanying text.

377. For examples of those who have made this argument in an international context, see Steven Brull, *Sony Links Executive Pay to Stocks*, INT’L HERALD TRIB., Aug. 11, 1995, at 11; Ira T. Kay, *High CEO Pay Helps US Economy Thrive*, WALL ST. J., Feb. 23, 1998, at A22; David S. Milstein, *Pay Japan’s Executives to Perform*, ASIAN WALL ST. J., Apr. 12, 1999, at 10.

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the United States at the end of the 1990s stock market boom (such as Enron Corp., WorldCom Inc., and Tyco International Ltd.), policymakers elsewhere might see borrowing from the American model of capitalism as unwise.<sup>378</sup> Most pertinent for present purposes, policymakers might conclude that, in the case of executive pay, drawbacks to the American approach would make imitation undesirable. As Bebchuk, Fried, and Walker have argued, managerial compensation in the United States arguably is a manifestation of counterproductive “rent extraction,” not the product of fair-minded efforts to align the interests of shareholders and executives.<sup>379</sup> Also, American-style incentivized compensation packages could tempt executives to engage in misleading or dishonest earnings management in order to prop up their share prices until they can unload their equity.<sup>380</sup>

An additional reason why the U.S. approach to executive pay might be thought of as an inappropriate model for other countries is that unswerving confidence in the notion of the all-powerful “superstar” CEO underpinned the shift towards lucrative performance-oriented pay in American public companies. Even Americans are now acknowledging that a quiet, understated leadership style might be more likely to deliver strong results.<sup>381</sup> At the same time, there might be fears that the awarding of U.S.-style compensation would foster resentment among rank-and-file employees, with a consequent drop in morale and productivity.<sup>382</sup> Finally, in strongly egalitarian countries, a growing gap between ordinary workers’ wages and corporate leaders’ soaring fortunes would be societally objectionable in itself.<sup>383</sup>

This Article provides guidelines for regulators called upon to address the potential Americanization of executive pay. If a regulator prefers to curb convergence in an American direction, our analysis suggests the most direct course of action would be to orchestrate an increase in the top marginal rate of

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378. Evelyn Iritani, *U.S. Business Model a Tough Sell Overseas*, L.A. TIMES, July 7, 2002, at A1; *Wave of Corporate Scandals Could Tilt World Business Away from American Model*, WALL ST. J., June 28, 2002, at A10.

379. See *supra* note 15 and accompanying text. It cannot be taken for granted, however, that the diagnosis that Bebchuk, Fried, and Walker offer is correct. See Thomas, *supra* note 14; Holman W. Jenkins, *Outrageous CEO Pay Revisited*, WALL ST. J., Oct. 2, 2002, at A17.

380. John C. Coffee, *What Caused Enron? A Capsule Social and Economic History of the 1990’s* 35-39, 42 (2003) (Columbia Law School Center for Law and Economic Studies Working Paper No. 214); David Millon, *Why Is Management Obsessed with Quarterly Earnings and What Should be Done About It?*, 70 GEO. WASH. L. REV. 890, 906-9 (2002).

381. Robert J. Shiller, *Celebrity CEOs Share the Blame for Street Scandals*, WALL ST. J., June 27, 2002, at A20; Michael Skapinker, *A Lower Profile for the Superstar Executives*, FIN. TIMES, FT Survey, The World 2003, at 7; *What’s Wrong with Executive Compensation? A Roundtable Moderated by Charles Elson*, HARV. BUS. REV., January 2003, at 5, 10-11. See generally JAMES C. COLLINS, *GOOD TO GREAT: WHY SOME COMPANIES MAKE THE LEAP... AND OTHERS DON’T* (Harper Business, 2001); RAKESH KHURANA, *SEARCHING FOR A CORPORATE SAVIOUR: THE IRRATIONAL QUEST FOR CHARISMATIC CEOs* (Princeton University Press, 2002).

382. On this possibility, see CHEFFINS, *supra* note 17, at 658; Murphy, *supra* note 12, at 2554.

383. See, e.g., Bryant, *supra* note 9; McMurdy, *supra* note 345.



income tax. This is because under the new conditions, executives would know that they would keep less of what they earned and thus would not press as hard for lucrative remuneration.<sup>384</sup> On the other hand, the politics of taxation are delicate and it is doubtful whether concern about the level of managerial compensation could ever provide, in isolation, a sufficiently strong political platform for a more progressive tax regime.<sup>385</sup>

Tax reform is not the only regulatory strategy available to policymakers seeking to impede the Americanization of managerial remuneration, but there is reason to doubt whether the alternatives would achieve the desired objective. For instance, the analysis offered here indicates that amending corporate law to introduce “direct” regulation of executive pay, strengthen directors’ duties, or impose new shareholder voting requirements would likely not cause a significant reconfiguration of managerial compensation. Bolstering disclosure requirements would also be unwise and might indeed serve to accelerate the Americanization of executive pay. Moreover, deploying “soft law” would not be a particularly promising alternative. Consider Britain. Detailed “soft law” guidance was put in place during the mid-1990s and those setting executive pay were instructed to take into account the “wider scene.”<sup>386</sup> Nevertheless, managerial remuneration subsequently rose substantially in U.K. companies.<sup>387</sup>

Assume now that our policymaker has concluded that the preferred course of action is to foster a shift towards the U.S. executive pay model. Under such circumstances, introducing stronger disclosure requirements would be a prudent course to follow. The primary reason would be that shareholders, having additional information at hand, would be well situated to press for compensation packages that linked pay more closely with performance. Also, the likelihood that enhanced disclosure regulation might well foster an upward ratchet in executive pay would presumably be an acceptable by-product of reform.

Another approach that a policymaker who is favorably disposed towards U.S.-style executive pay might adopt would be to promote the unwinding of control blocks in domestic companies. All else being equal, a company with a “core” shareholder will probably have lower executive pay than its widely held counterpart, and performance-oriented compensation will likely play a less important role. A popular thesis at present is that a country that wants to foster outside investment in domestic companies can “jump start” a move in this direction by enacting laws designed to protect minority shareholders.<sup>388</sup> It is by

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384. See *supra* note 276 and accompanying text.

385. CHEFFINS, *supra* note 17, at 706-7.

386. *Supra* note 319 and related discussion.

387. Charles Arthur, *The Fat Cats are Back*, THE INDEP. (London), July 25, 2000, at 3; Philip Thornton, *Executive Pay Increase Set to Revive Row*, THE INDEP. (London), Oct. 23, 2000, at 15.

388. On this line of thinking, see Cheffins, *Bedrock*, *supra* note 120 at 5-6, 16.

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no means certain whether any such attempt will succeed.<sup>389</sup> Still, for a country that does make a law-driven transition towards the sort of dispersed pattern of ownership that prevails in the United States and Britain, a likely by-product would be at least a partial shift towards the American model of executive pay.

This Article has not sought to address explicitly whether a move towards the U.S. model of executive pay would be a “good thing.” Instead, the purpose here has primarily been descriptive, namely identifying and discussing the variables likely to influence global managerial remuneration trends. The analysis that has been offered here, however, does have significant normative ramifications. Specifically, this Article provides a “check list” of factors that policymakers outside of the United States can take into account once they have formulated a policy on executive pay. Thus, while those wondering whether the Americanization of executive pay would be a “good thing” will need to find their answers elsewhere, this Article offers valuable guidance for those seeking to implement policy decisions.

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389. *Id.* at 16-23.

