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Glory Days

CEO Pay in Canada Soaring to Pre-Recession Highs

Hugh Mackenzie

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CEO Pay in Canada Soaring to Pre-Recession Highs

Introduction

Canada's economy has not yet emerged from the Great Recession triggered by the 2007–08 financial crash. Despite an anticipated return to balanced federal budgets in 2015, Canadians can expect at least a few more years of sluggish growth and less-than-stellar job creation.

But one trend from before the recession has rebounded spectacularly: CEO pay. Average corporate compensation in 2013 was $9.2 million — the second highest it has been since 2005, when the Canadian Centre for Policy Alternatives first started monitoring the trend. The last time CEO compensation was this high, Canada was at the peak, before the crash in 2007. That year, Canada's highest paid 100 CEOs averaged $10 million.

As in previous years, the following analysis is based on the earnings of CEOs at the 240 publicly listed Canadian corporations on the TSX Index, as reported in proxy circulars issued in 2014 covering earnings in 2013. We find that by 11:41 a.m. on January 2, 2013 — the second paid day and first working day of the year — the average top CEO had earned as much money as the average Canadian worker would make all year.

This report breaks down the compensation details of the highest paid 100 CEOs and, given the persistence of outrageous CEO pay, it assesses the poor record of voluntary restraint and shareholder activism in reining in

CEO compensation. It concludes that it is time to consider simple tax measures that provide a much more effective approach to closing the income gap in Canada.

CEO Pay vs. Average Pay in Canada

A survey of compensation tables in the proxy circulars for the 240 publicly listed Canadian firms on the TSX Index shows the average compensation of the top 100 CEOs was $9,213,416 in 2013. To put that into perspective, the total compensation of these executives ($921 million) exceeds the reported budgetary deficits for 2013–14 of every province in Canada with the exception of Ontario and Quebec.

While changes in reporting requirements make it difficult to compare 2013 CEO compensation with pre-2008 levels, trends for both CEOs and average workers since 2008 — Canada's first recessionary year in the global economic meltdown — are still revealing.

In 2008, average reported compensation for the top 100 CEOs was $7.35 million. In 2013, as noted, it was $9.21 million, which represents an increase of 25%. Over the same time period, the industrial composite average weekly wage in Canada reported by Statistics Canada increased by 12.3%. As a result, the average CEO's earnings surpassed those of the average Canadian worker (average pay was $47,358 in 2013) earlier in the year in 2013 than they did in 2008 — at 11:41 a.m. last year compared to 1:02 p.m. five years earlier.

Pay has become more equitable in Canada…for CEOs. In 2008, the lowest paid CEO in the top 100 reported compensation of $3.18 million. In 2013, the lowest paid of the top 100 took home $4.14 million, an above average increase of 30%. The composition of executive earnings also changed slightly over this period. Bonus payments increased from 22% of pay in 2008 to 25% in 2013, share grants from 26% to 27%, and stock options awarded from 21% to 26% of total compensation.

Canada's lowest paid workers have not fared so well throughout the recession. The weighted average minimum wage in Canada increased by 13%, from $9.02 in 2008 to $10.20 in 2013, roughly reflecting the average wage increase overall. As a result, the average CEO had earned as much as the average minimum wage employee in Canada by 1:47 p.m., January 1, 2013, compared to 2:21 p.m. in 2008.

Compensation data for the top 100 CEOs lets us go back to 1998, when the average of the top 100 was 105 times more than the average Canadian's

FIGURE 1 Canada's Top Paid CEOs and the Rest of Us

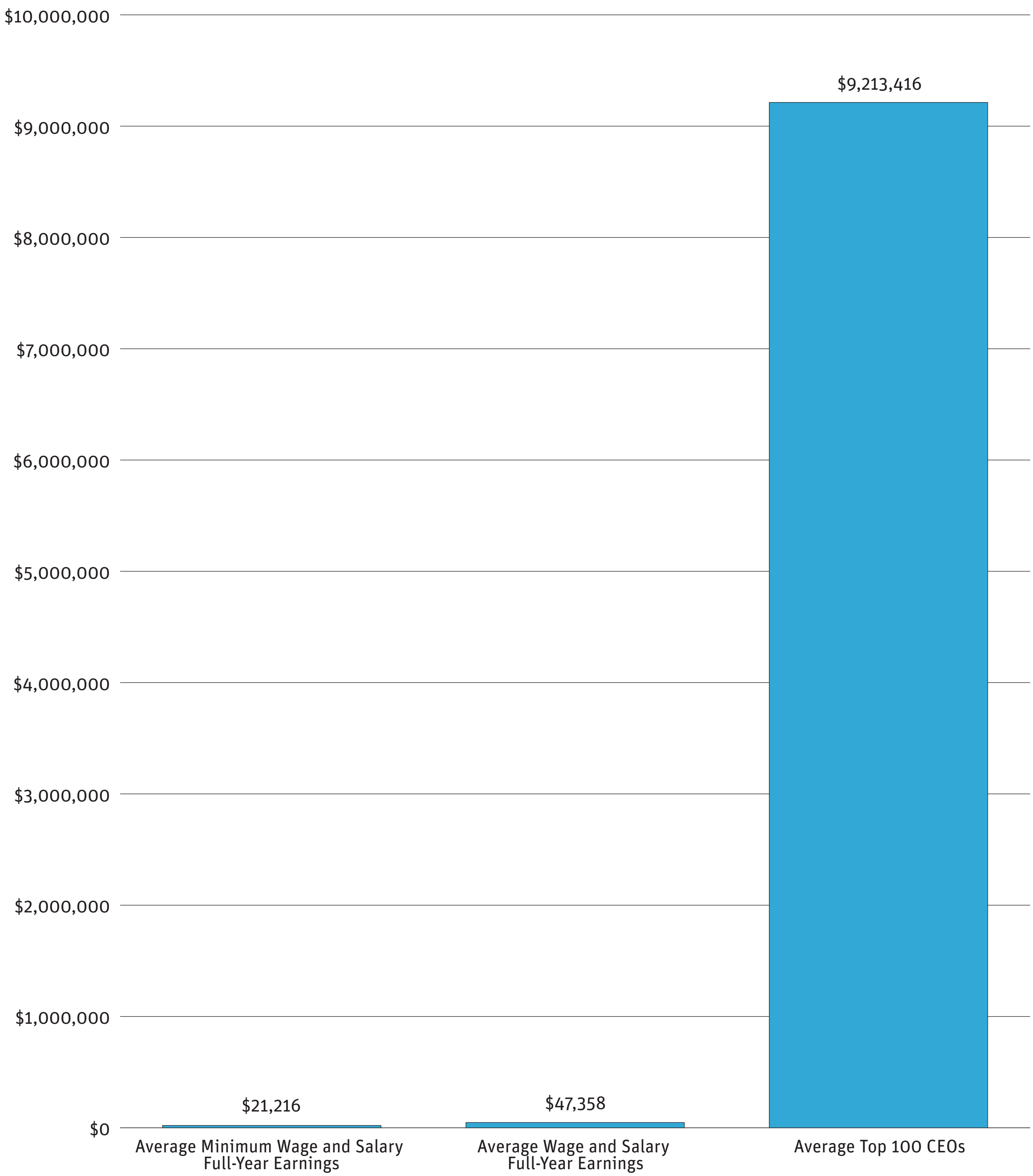
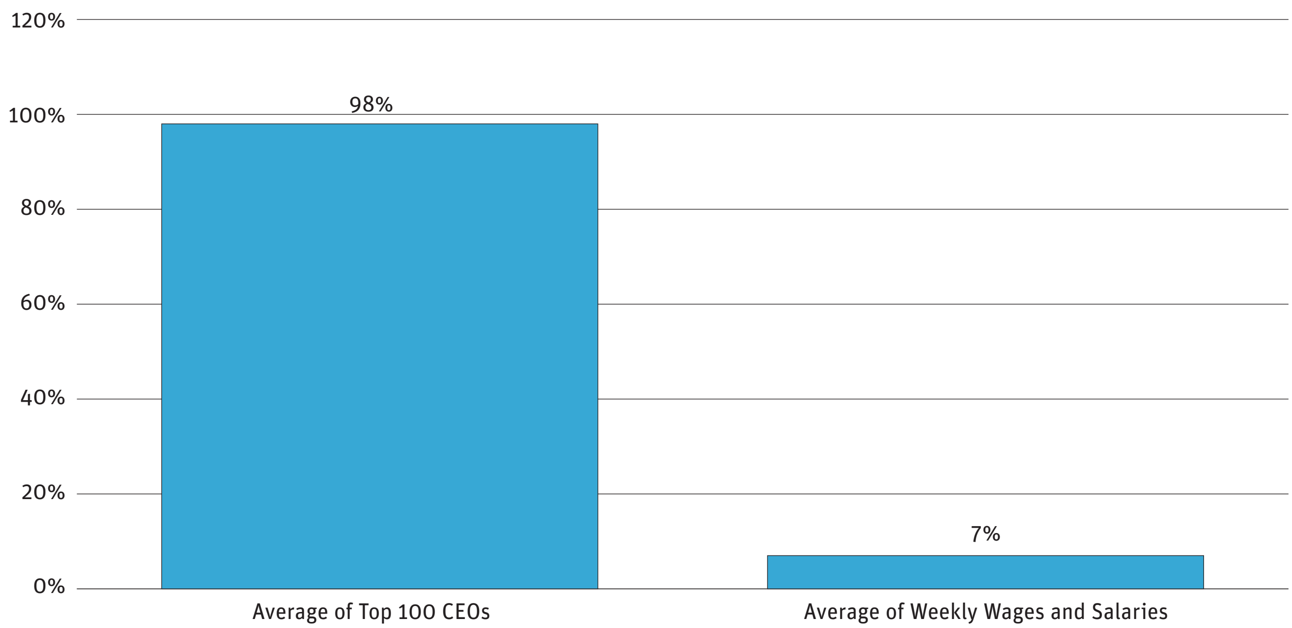


FIGURE 2 Inflation Protection? Percentage Change in Employment Earnings After Adjusting for Inflation, 1998–2013



employment earnings. In 2013, the top 100 CEOs in Canada took home 195 times more than the average Canadian's pay.

When you adjust 2008 pay for inflation, an even more dramatic picture emerges. Adjusted for inflation, the average pay of the top 100 CEOs has increased by 98% while the average Canadian's pay grew by 7%. We should keep in mind that this includes the most severe economic recession since the 1930s — a recession from which Canada has not yet fully recovered.

Looking back to 1995, the first year these data became available after regulatory changes on corporate disclosure were enacted in 1993, we can compare the compensation of the 50 highest paid CEOs with the corresponding group's pay today. In 1995, the 50 highest paid CEOs in Canada earned 85.3 times what the average Canadian worker made. In 2013, this ratio had tripled: the highest paid CEOs were making 269.7 times the average Canadian income.

While hard data of this kind aren't available in Canada prior to 1995, it is generally accepted that in the United States the ratio of CEO pay to average pay in the late-1980s was approximately 40:1, and that Canada's ratio would have been somewhat lower.

TABLE 1 Top Paid CEO Listing

Rank	Name	Company	Base Salary	Bonus	Shares	Options	Pension	Other	Total
1	**Gerald W. Schwartz**	Onex Corporation	1,339,611	25,178,068	-	61,399,347	-	-	**87,917,026**
2	**Nadir Mohamed**	Rogers Communications Inc.	1,130,769	1,500,000	2,520,440	2,520,044	1,856,084	17,242,636	**26,769,973**
3	**Michael M. Wilson**	Agrium Inc.	1,507,200	1,975,012	2,977,075	2,785,916	1,020,076	13,553,461	**23,818,740**
4	**Donald J. Walker**	Magna International Inc.	334,903	9,734,850	6,489,900	2,810,195	-	187,752	**19,557,600**
5	**Steven K. Hudson (partial year)**	Element Financial Corp	660,000	4,728,394	5,250,258	8,226,376	-	-	**18,865,028**
6	**JR Shaw (Exec Chair)**	Shaw Communications, Inc.	1,500,000	10,140,700			5,603,000	136,832	**17,380,532**
7	**Robert Dépatie (partial year)**	Quebecor Inc	1,200,000	3,906,447	-	8,820,000	894,700	-	**14,821,147**
8	**Gordon M. Nixon**	Royal Bank of Canada	1,500,000	2,932,000	6,600,000	1,650,000	1,312,000	44,877	**14,038,877**
9	**Doug Suttles**	Encana Corporation	562,830	969,403	7,129,178	4,127,419	40,023	945,242	**13,774,095**
10	**Paul Colborne**	Surge Energy Inc	-	450,000	1,744,400	11,473,616	-	7,925	**13,675,941**
11	**Steven W. Williams**	Suncor Energy Inc.	1,291,346	2,420,000	4,687,224	4,453,600	-	149,560	**13,001,730**
12	**Bradley Nullmeyer (President)**	Element Financial Corp	548,000	3,592,930	4,154,432	4,650,622	-	-	**12,945,984**
13	**Scott Saxberg**	Crescent Point Energy Corp.	508,800	463,000	11,805,666	-	-	7,808	**12,785,274**
14	**Donald Guloien**	Manulife Financial Corporation	1,216,641	4,249,647	3,975,048	2,650,032	568,800	103,381	**12,763,549**
15	**Bradley Shaw (CEO)**	Shaw Communications, Inc.	2,500,000	6,325,000	-	-	3,201,270	400,584	**12,426,854**
16	**Mark Thierer**	Catamaran Corporation	1,030,470	966,066	8,723,573	1,662,077	-	42,249	**12,424,435**
17	**W.P. Buckley**	ShawCor Ltd	900,000	3,249,220	-	1,449,227	5,450,000	1,096,898	**12,145,345**
18	**Richard E. Waugh (partial year)**	The Bank of Nova Scotia	1,500,000	1,400,000	4,932,000	3,288,000	-	85,612	**11,205,612**
19	**R. Jeffrey Orr**	Power Financial Corporation	4,134,000	500,000	2,197,673	1,960,569	1,949,000	440,202	**11,181,444**
20	**George A. Cope**	BCE Inc.	1,400,000	2,891,700	4,406,250	1,468,750	629,579	167,169	**10,963,448**
21	**Peter Marrone**	Yamana Gold, Inc.	1,521,598	3,229,356	4,020,861	1,130,602	667,452	138,949	**10,708,818**
22	**Edmund Clark**	The Toronto-Dominion Bank	1,500,000	1,600,000	4,850,000	2,350,009	-	136,875	**10,436,884**
23	**Charles A. Jeannes**	Goldcorp Inc.	1,500,880	1,962,017	4,041,007	2,184,441	409,560	102,509	**10,200,414**
24	**Darren Entwistle**	TELUS Corporation	1,375,000	713,742	7,513,742	-	441,000	84,218	**10,127,702**
25	**Gerald T. McCaughey**	Canadian Imperial Bank of Commerce	1,500,000	3,119,600	3,743,520	935,880	717,000	-	**10,016,000**
26	**Donald R. Lindsay**	Teck Resources Limited	1,450,000	2,225,800	2,679,845	2,672,355	552,000	309,974	**9,889,974**
27	**Geoffrey T. Martin**	CCL Industries Inc	864,483	1,750,830	6,165,000	635,500	215,083	-	**9,630,896**
28	**Harold N. Kvisle**	Talisman Energy Inc.	1,299,996	1,558,700	6,606,001	-	-	78,822	**9,543,519**
29	**William A. Downe**	Bank of Montreal	1,279,375	1,300,000	5,650,000	1,250,000	-	13,050	**9,492,425**
30	**Sean Boyd**	Agnico Eagle Mines Limited	1,500,000	2,700,000	5,093,000	-	82,970	20,200	**9,396,170**
31	**Steve W. Laut**	Canadian Natural Resources Limited	620,000	5,319,000	-	3,196,000	-	113,828	**9,248,828**
32	**Brian C. Ferguson**	Cenovus Energy Inc.	1,337,500	1,755,000	2,699,981	2,700,017	619,882	132,394	**9,244,774**
33	**Thorsten Heins**	BlackBerry Limited	999,973	1,715,578	2,996,997	3,187,645	14,761	141,058	**9,056,012**
34	**J. Paul Rollinson**	Kinross Gold Corporation	1,162,617	1,743,926	4,269,906	1,067,476	435,982	255,303	**8,935,210**
35	**Michael E. Roach**	CGI Group, Inc.	1,250,000	1,585,132	5,925,372	-	-	57,016	**8,817,520**
36	**Russell Girling**	TransCanada Corp.	1,300,008	1,950,000	3,000,000	2,200,000	217,000	33,001	**8,700,009**
37	**James C. Smith**	Thomson Reuters Corporation	1,597,229	2,834,761	1,996,730	1,996,552	-	30,533	**8,455,805**
38	**Dean A. Connor**	Sun Life Financial Inc.	988,462	2,300,000	3,562,513	1,187,502	356,090	8,545	**8,403,112**
39	**Craig H. Muhlhauser**	Celestica Inc	1,000,000	1,525,000	5,500,000	-	115,000	188,723	**8,328,723**
40	**Claude Mongeau**	Canadian National Railway Company	1,055,648	1,644,443	3,210,050	1,609,300	628,000	82,191	**8,229,632**
41	**Asim Ghosh**	Husky Energy Inc.	1,642,250	2,441,000	3,035,216	804,174	147,803	122,046	**8,192,489**
42	**Jamie C. Sokalsky**	Barrick Gold Corporation	1,400,677	875,423	5,220,114	-	341,415	135,076	**7,972,705**
43	**Miguel de la Campa (Exec. Co-Chair)**	Pacific Rubiales Energy Corp.	995,118	1,595,405	-	5,212,862	-	151,413	**7,954,798**
44	**Alain Bouchard**	Alimentation Couche-Tard Inc.	1,312,500	5,952,993	-	-	662,853	-	**7,928,346**
45	**Serafino Iacono (Exec. Co-Chair)**	Pacific Rubiales Energy Corp.	995,118	1,595,405	-	5,212,862	-	117,169	**7,920,554**
46	**Ronald Pantin (CEO)**	Pacific Rubiales Energy Corp.	995,118	1,595,405	-	5,212,862	-	110,594	**7,913,979**
47	**Jose Francisco Arata (President)**	Pacific Rubiales Energy Corp.	946,288	1,595,405	-	5,212,862	-	131,296	**7,885,851**
48	**Paviter S. Binning**	George Weston Limited	1,000,000	1,901,700	2,666,666	1,333,337	38,000	945,965	**7,885,668**
49	**Calin Rovinescu**	Air Canada	1,400,000	2,260,800	2,623,902	1,241,867	290,800	-	**7,817,369**
50	**André Desmarais (Co-CEO)**	Power Corporation of Canada	1,100,000	1,750,000	187,500	3,080,400	981,000	641,000	**7,739,900**

TABLE 1 Top Paid CEO Listing (Continued)

Rank	Name	Company	Base Salary	Bonus	Shares	Options	Pension	Other	Total
51	**Paul Desmarais, Jr. (Co-CEO)**	Power Corporation of Canada	1,100,000	1,750,000	187,500	3,080,400	993,000	547,862	**7,658,762**
52	**Louis Vachon**	National Bank of Canada	1,000,009	1,635,000	2,500,000	2,000,023	168,000	315,471	**7,618,503**
53	**Pierre Karl Péladeau (partial year)**	Quebecor Inc	1,083,333	5,241,209	-	1,072,497	29,800	1,297	**7,428,136**
54	**Stephen G. Wetmore**	Canadian Tire Corp. Ltd.	1,250,000	2,046,250	1,874,975	1,874,991	-	381,159	**7,427,375**
55	**Paul N. Wright**	Eldorado Gold Corp.	1,514,000	2,195,300	1,854,650	1,854,650	-	-	**7,418,600**
56	**J. Michael Pearson**	Valeant Pharmaceuticals International, Inc.	1,803,323	4,935,468	-	-	-	472,164	**7,210,955**
57	**E. Hunter Harrison**	Canadian Pacific Railway Limited	2,266,718	4,429,600	-	-	11,000	499,046	**7,206,364**
58	**Brian Porter (partial year)**	The Bank of Nova Scotia	800,000	1,250,000	3,000,000	2,000,000	-		**7,050,000**
59	**Paul A. Mahon**	Great-West Lifeco Inc.	800,077	1,416,570	279,238	410,321	3,950,784	137,867	**6,994,857**
60	**Robert Sawyer**	RONA Inc	604,811	850,000	4,444,000	571,054	108,900	33,491	**6,612,256**
61	**William J. Doyle**	Potash Corp. of Saskatchewan, Inc.	1,294,889	824,376	-	4,281,910	-	164,436	**6,565,611**
62	**H. Stanley Marshall**	Fortis Inc.	1,200,000	1,836,000	2,399,987	558,911	331,080	199,074	**6,525,052**
63	**Frank Hasenfratz (Chairman)**	Linamar Corp	424,580	4,545,024	1,130,676	-	-	344,472	**6,444,752**
64	**John Floren**	Methanex Corporation	750,250	1,508,000	1,851,330	1,857,703	151,550	159,874	**6,278,707**
65	**Pierre Beaudoin**	Bombardier Inc.	1,401,851	956,997	2,407,178	1,203,589	86,250	132,415	**6,188,280**
66	**Linda Hasenfratz (CEO)**	Linamar Corp	576,660	4,598,063	617,250	-	3,500	328,539	**6,124,012**
67	**Randy V.J. Smallwood**	Silver Wheaton Corp.	871,963	1,482,337	1,451,683	2,224,707	-	-	**6,030,690**
68	**David L. French**	Bankers Petroleum Ltd	391,000	410,891	37,500	4,305,319	-	724,920	**5,869,630**
69	**Nancy C. Southern**	Canadian Utilities and ATCO	1,000,000	1,500,000	1,186,707	1,092,000	877,632	35,000	**5,691,339**
70	**J. Bruce Flatt**	Brookfield Asset Management Inc.	515,235	-	5,147,198	-	-	22,520	**5,684,953**
71	**L. Scott Thomson**	Finning International Inc.	467,308	294,185	2,399,550	2,399,550	56,077	24,652	**5,641,322**
72	**Robert G. Card**	SNC-Lavalin Group Inc.	934,622	576,500	1,921,296	1,980,277	-	216,895	**5,629,590**
73	**Paul Reynolds**	Canaccord Genuity Group Inc	750,000	3,070,000	1,771,591	-	-	8,652	**5,600,243**
74	**Jay S. Hennick**	FirstService Corp/Canada	1,692,974	3,809,140	-	-	-	-	**5,502,114**
75	**Al Monaco**	Enbridge Inc.	1,030,000	1,222,860	1,200,672	1,248,050	652,000	87,913	**5,441,495**
76	**Edward Sonshine**	Riocan Real Estate Investment Trust	1,200,000	2,460,000	-	1,712,814	-	-	**5,372,814**
77	**Rich Kruger**	Imperial Oil Ltd.	590,905	492,292	4,194,346	-	-	-	**5,277,543**
78	**Vincente Trius (President)**	Loblaw Companies Limited	1,000,000	1,638,919	1,666,448	833,460	38,000	87,644	**5,264,471**
79	**M.H. McCain**	Maple Leaf Foods Inc	1,018,142	-	2,010,889	2,009,250	201,454	-	**5,239,735**
80	**Mark Davis**	Chemtrade Logistics Income Fund	700,000	4,156,111	-	-	350,000	26,480	**5,232,591**
81	**José Boisjoli**	BRP Inc/CA	925,000	1,097,281	-	2,842,009	326,000	34,113	**5,224,403**
82	**Marcel R. Coutu**	Canadian Oil Sands Limited	880,000	416,130	1,210,000	1,210,000	-	1,478,800	**5,194,930**
83	**Marigay McKee (President of Saks fifth ave)**	Hudson's Bay Co	171,667	-	1,499,994	1,500,000	-	2,000,000	**5,171,661**
84	**Gerald S. Panneton (partial year)**	Detour Gold Corp	651,671	-	-	437,400	-	3,994,469	**5,083,540**
85	**Glenn J. Chamandy**	Gildan Activewear Inc.	849,219	1,601,885	1,208,773	1,208,897	41,901	80,379	**4,991,054**
86	**John M. Cassaday**	Corus Entertainment Inc	955,325	1,459,741	1,432,988	477,663	466,000	144,900	**4,936,617**
87	**Alain Bédard**	TransForce Inc	1,050,000	1,386,000	-	1,973,846	341,900	141,873	**4,893,619**
88	**Robert A. Gannicott (CEO)**	Dominion Diamond Corp	1,016,135	1,573,773	-	2,229,519	-	-	**4,819,427**
89	**Christopher G. Huskilson**	Emera Incorporated	871,635	1,358,438	962,542	962,445	579,000	32,120	**4,766,180**
90	**David Roberts**	Penn West Petroleum Ltd.	400,000	375,000	2,872,500	891,000	-	211,699	**4,750,199**
91	**Galen G. Weston (Exec. Chair)**	Loblaw Companies Limited	1,000,000	1,092,613	1,666,448	833,460	-	129,351	**4,721,872**
92	**Tim Gitzel**	Cameco Corporation	918,000	785,000	1,652,200	1,100,625	264,500	-	**4,720,325**
93	**Charles Brindamour**	Intact Financial Corporation	849,808	1,641,563	1,700,000	-	413,188	-	**4,604,559**
94	**Stephen A. MacPhail**	CI Financial Corp	750,000	3,250,000	-	576,000	-	-	**4,576,000**
95	**David Demers**	Westport Innovations Inc	700,000	648,375	3,140,815	-	-	11,910	**4,501,100**
96	**James Riddell**	Trilogy Energy Corp	-	340,850	2,940,700	1,202,129	-	3,162	**4,486,841**
97	**David Fesyk**	Inter Pipeline Ltd.	650,000	2,000,000	1,500,000	-	-	331,450	**4,481,450**
98	**Pierre J. Blouin**	Manitoba Telecom Services Inc	850,000	667,951	2,681,299	-	-	76,500	**4,275,750**
99	**James L. Bowzer**	Baytex Energy Corp.	575,000	600,000	3,002,800	-	-	57,500	**4,235,300**
100	**Thomas J. Simons**	Canadian Energy Services & Technology Co	400,000	1,417,432	2,302,633	-	-	19,201	**4,139,266**

Note Ranks #11, 37, 55 and 58 — negative entries for pension disregarded; arise from difference between actual and projected salary, and do not represent an in-year reduction in pension entitlement. Rank 77 — negative entries for "Pension" and "Other" disregarded; related to intracorporate transers within the EXXON group. Where compensation is stated in US dollars, converted to Canadian dollars using the average exchange rate for 2013.

Meanwhile, the gender pay gap remains alive and well in Canada. For women working full-time for the full year, average pay in 2013 was 72% of men's average pay — just under $39,000. The average CEO in the top 100 in 2013 made 237 times the pay of an average woman.

Richer Than You Think

As high as executive pay is today, the published compensation data don't present the complete picture. A significant proportion of each CEO's reported pay is an estimate of the value of stock options granted during the year; a conservative estimate that does not capture the additional benefit in the favourable income tax treatment of options. Almost half of the 100 highest paid CEOs also have stratospheric pensions waiting for them when they retire. And most also profit handsomely from the dividends paid on the shares they own in the companies they work for.

Options: It's Nice to Have Some

Let's look at stock options. As high as the numbers are, as reported in proxy circulars they actually understate the value of options, in two important respects.

First of all, a stock option is not actual cash when it is granted. When a corporation grants stock options to an executive, it gives the executive the right to buy a given number of shares of the corporation at a predetermined price, known as the strike price. The strike price is normally the market price of the stock on the day the option is granted. When the price of the stock goes above the strike price, the difference represents the value of the option, because the executive could exercise his or her option at the strike price and sell at the higher price.

The values for stock option grants reported in proxy circulars since 2008 are generally determined using a statistical methodology known as the Black-Scholes method, named after its creators. The method develops an estimated value for an option based on statistical descriptions of the stock's price history. That valuation methodology has tended to produce conservative estimates of the value of the stock options granted to corporate executives.

To illustrate the process, consider the options granted to the CEOs of Canada's largest chartered banks in the period 2008–13. During this time, the five largest chartered banks in Canada reported CEO compensation in the form of stock options amounting to a total of $70.3 million. The values reported by each bank were calculated using standard statistical methodologies and based on the number of options granted, the strike price (normally the price of the shares on the date of grant), the vesting date (the earliest date the option can be exercised) and the expiration date (the latest date the option can be exercised). But if we look at share prices as of November 4, 2014, those options actually turned out to have been worth $169.0 million, or more than 2.4 times what was estimated for proxy reporting purposes.[1]

The second reason why we have to look more carefully at stock options as a component of executive pay is because of the way they are taxed.

When a CEO actually exercises previously-granted stock options (i.e. exercises his or her right to buy the stock at the predetermined price) the income crystallized in the transaction is taxed at half the normal rate, as if it were a capital gain rather than ordinary income. So from an after-tax perspective, a dollar received from the exercise of a stock option is worth two dollars of salary income.

The difference in tax paid — half the top marginal rate of taxation, or 26% on average across Canada — amounts to a public subsidy paid to these already highly compensated executives. This is all the more significant given how common stock options are as a form of executive pay.

Among the highest paid 100 CEOs in Canada in 2013, 75 received stock options as part of their pay package; 75 had previously-granted but unexercised "in the money" options; 65 had both current and previously-granted in-the-money options. The average estimated option value, for those granted options in 2013, was $3.16 million. The total value of the unexercised "in the money" options was $1.59 billion, an average of $21.2 million for each of the 75 CEOs with unexercised options.

At a subsidy rate of half the top marginal rate of 52%, or 26%, the estimated tax subsidy for the options granted to the top 100 CEOs in 2013 is $82 million, and the anticipated tax subsidy related to their stockpile of unexercised "in the money" options is $413 million, for a total of more than half a billion dollars.

Pensions: The Gift That Keeps on Giving

As generous — some might say excessive — as the compensation of Canada's top CEOs would appear to be, the benefits flowing from being a CEO don't stop with retirement. While only about 11% of employees in the private sector in Canada belong to a defined benefit pension plan, nearly half (43%) of the top 100 CEOs will be covered for life when they retire.

How Comfortable Will These Executives Be?

Whereas we have no idea how adequately pension plans will cover that 11% of private sector workers when the time comes, thanks to compensation disclosure rules, we know the average annual pension payable at age 65 to the 43 CEOs in the top 100 with defined benefit pension plans comes to a spectacular $1.39 million.

To put that number into perspective, it exceeds by nearly 9% the average base salary of those same 43 executives.

Shares: The Pride (and Benefits) of Ownership

Between the shares accumulated through grants of stock in annual compensation and the equity ownership of founders and/or controlling shareholders who also serve as CEOs, Canada's 100 highest paid CEOs have accumulated substantial wealth in the form of shares in the companies they manage.

As a group, they report ownership of shares in their companies amounting to $9.8 billion, or an average of $98 million each. As share owners, the same 100 CEOs would have received dividends in 2013 amounting to an estimated $128 million ($1.28 million each).

Extraordinary Executive Pay: Does It Make Sense?

Governments and citizens around the world continue to focus attention on the astronomical salaries pocketed by CEOs. Especially in the U.S., there has been particularly strong public and political outrage at the payment of enormous bonuses to executives (and some of their high-flying employees) who have overseen the wiping out of billions of dollars in shareholder value since the crash of 2007–08.

For years, citizens have been told CEO pay is a reward for good performance. That claim has sounded more than a little hollow in the wake of the past recession. Two leading Canadian business thinkers, Roger Martin and Henry Mintzberg, have been weighing in heavily on the issue.

An analysis by Martin, former dean of the University of Toronto's Rotman School of Management, proposes that compensating CEOs based on stock prices (e.g. through share grants or stock options) rewards them for something they cannot influence or control.[2] This is all the more strange, he reasons, because stock markets are "expectations markets," in that the price of a company's shares is based not on the performance of the company in the past but on what investors expect the performance of the company to be in the future.

Using a football analogy, Martins likens paying a CEO based on share prices to paying a football quarterback based on whether or not his team beats the betting points spread. Not only does the points spread (the expectations market) have nothing to do with the quarterback's performance on the field, in football it is illegal for a quarterback to participate in that market. Using the same logic, Martin argues that CEOs should receive bonuses based on how their companies perform, the business plans they set, and profits they generate, rather than on how the bets placed by investors influence the value of their shares.

Martin concludes:

> If we are to emerge from this mess, executives must switch their focus entirely to the real market and completely ignore the expectations market. This entails building skills and experience in building real products, developing real consumers and earning real profits...While these proposals might seem draconian, they are absolutely necessary to save corporations from themselves. Customers and employees will only accept the legitimacy of a business if its executives put customers and employees ahead of shareholders who buy shares from existing shareholders; companies will only become skilled at creating real value if they don't spend their time on the expectations market; and the negative impact of hedge funds will only diminish if executives stop spending their time jerking around expectations.

Mintzberg, the renowned Canadian business thinker, starts from the same premise as Martin — that compensation should match performance — but goes much further in a November 2009 *Wall Street Journal* article arguing that corporate leaders should not be paid bonuses at all.[3] He explains:

> This may sound extreme. But when you look at the way the compensation game is played — and the assumptions that are made by those who want to reform it — you can come to no other conclusion. The system simply can't be fixed. Executive bonuses — especially in the form of stock and option

> grants — represent the most prominent form of legal corruption that has been undermining our large corporations and bringing down the global economy. Get rid of them and we will all be better off for it.

Despite the recession, the public outrage, the criticism of political leaders, and the devastating analyses of key business thinkers, the practice of compensating Canadian CEOs has not changed perceptibly since the global economic meltdown.

The standard response to concerns about excessive executive compensation is that it is a discussion best left to corporate boards whose directors should see the benefit of reining in salaries. But the evidence up to 2014 suggests this approach isn't working. Even the advent of advisory votes ("Say on Pay") by shareholders has had little, if any, noticeable impact on compensation decisions by corporate boards, leaving us to conclude the will for reform simply isn't there, despite the public utterances of several high-profile investors.

This leaves those who believe that the corporate sector can manage its own compensation with two options. The first is voluntary restraint on the part of North American CEOs. The second would be regulatory changes to corporate governance that would have the effect of taking executive compensation decisions away from corporate boards and their self-reinforcing advisors. Failure to act in one of these directions could spark a hard political response, according to Martin in a more recent article for the *Harvard Business Review*:

> The trend [towards higher compensation] cannot proceed unabated in the United States without provoking a political reaction. Top executives, private equity managers, and pension funds can avoid such a reaction by showing the leadership of which they are fully capable and modifying their behavior to create a better mix of rewards for capital, labor, and talent.[4]

While Martin is correct to point to the significance of the growing gap between CEO and average compensation, there is very little evidence of the leadership, restraint, or self-discipline he says are necessary to avoid political intervention. The public reaction to soaring executive bonuses in the lead up to the financial crisis, coupled with the emergence of executive greed as a common theme in popular culture, has had no identifiable impact on compensation trends. While there has been the odd example of self-restraint (e.g. Canadian bank CEOs who voluntarily gave up stock options or other bonus payments in 2008), they have been the exception rather than the rule.

A Way Forward for Canada

It is increasingly clear that shareholders, working through their corporate boards of directors, are having a limited impact on decisions related to corporate compensation. There are good reasons why this type of voluntary restraint cannot adequately address the problem of runaway CEO pay.

In the first place, nearly everyone involved in determining compensation is 'in the club,' or in the same community of interest. It includes independent consultants who can only advise on what CEOs *are* paid, not what they should be paid. Compensation decisions for CEOs and, for that matter, other high flyers in the corporate world, are based on a circular logic. The club also includes fearful corporate boards. But those who do want to act face even further constraints.

To begin with, boards of directors are often totally dependent on the CEO they hire. Indeed, hiring someone to run your company is probably the most important decision the board gets to make, and there is a lot of pressure to get the right person. In the process, corporate boards find themselves in what game theorists call a prisoner's dilemma, which goes something like this. Every corporation would be better off if they all paid their CEOs less. But if one, and only one, takes that plunge, the corporation becomes a less attractive place to work than all other corporations. And because everyone is prepared to assume that executives are motivated only by money, that corporation's choice of CEOs will be much more limited. To put it simply, boards fear that by stepping outside the norm of excessive compensation they undermine their ability to hire the best people.

In theory, company shareholders, through "Say on Pay" provisions in corporate charters, are supposed to be able to send messages up the chain of command about executive compensation. Directors are supposed to ignore these messages at their peril. The fundamental problem is that "Say on Pay" votes happen remotely, once a year, where boards of directors meet in person many times during the year. The limited intervention means shareholders can *say* they are unhappy with executive compensation; it does not mean they can actually do anything about it.

Improving on this system by making shareholder votes on compensation binding would require changes to Canada's corporate governance system, with its reliance on the expertise and time commitment of corporate boards. It is a very unlikely prospect. That leaves government as the only actor left to inject sanity into an irrational compensation system. Government can do this through one of two approaches: regulation or the tax system.

There are two major problems with a regulatory approach. First, it would be next to impossible to separate legitimate, carefully thought out (e.g. performance-based) rewards to CEOs from other payments. This approach would also inevitably generate a storm of outrage from the business sector, ultimately threatening the acting government's political viability. Second, any regulatory regime would set in motion an elaborate game of entrapment between the regulated and the regulators, as we have already seen in the UK where attempts to rein in bonuses resulted in a shift away from bonuses to higher base pay.

The tax approach makes a lot more sense. If we, as a society, have concluded that excessive pay is unacceptable, we should be able to claw back a greater portion of it.

Corporations could continue to pay their executives whatever they wanted to. They'd just face a limit on what they could deduct for tax purposes. And executives would still have that all-important measuring stick indicating what they are "worth." The public will have made a clear statement of its view on excessive compensation practices. The impact of excessive pay on income inequality will be moderated. And the public will benefit from the public services that can be funded with this newly generated fiscal capacity.

Even without taking the step of raising taxes for well-compensated CEOs, Canada would benefit from ending the public subsidy inherent in the tax loophole that allows executives to pay half the income tax rate on the proceeds from cashing in stock options by claiming that revenue as capital gains. As calculated above, the stock options held by the highest paid 100 CEOs in 2013 stood to benefit from a tax break worth more than half a billion dollars.

Economists will dispute the value of corporate taxes and higher taxes on CEO compensation to government revenues. But the equalizing effect of these taxes, the need to close the growing income gap between the Canada's top earners and the rest of us, is valuable in its own right.

Conclusion

This annual review of CEO compensation shows Canada's chief executives are returning to their pre-recession glory days.

CEO pay has bounced back close to its 2007 level.

The highest paid 100 CEOs now earn 195 times more than the average Canadian income.

This paper reviews the trajectory of CEO pay over the past few decades and proposes a way forward to help narrow Canada's persistent income gap: in the absence of board and shareholder leadership to reduce CEO compensation practices, it's up to government — either through regulation or taxation. The author leans in the direction of higher taxation.

Notes

1 As it happened, three of the CEOs decided, in the atmosphere of controversy over executive compensation in the financial services industry during the financial crisis, to forego their 2008 options. Adjusting the numbers for the options foregone for 2008, the estimated option values totaled $65.5 million; the November 4, 2014 value of the remaining options was $148.2 million. Consequently, reported compensation for these five executives over the period understated actual compensation by $82.7 million.

2 Roger Martin, "Undermining Staying Power: The Role of Unhelpful Management Theories," *Rotman Magazine*, Spring 2009.

3 Henry Mintzberg, "No More Executive Bonuses!," *Wall Street Journal*, November 30, 2009.

4 Roger L. Martin, "The Rise (and Likely Fall) of the Talent Economy," *Harvard Business Review*, October 2014, quotation at page 9 of the article in reprint.

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