

*INTERNATIONAL EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE: HOW
A CROSS-CULTURAL ANALYSIS OF EXECUTIVE COMPENSATION REGULATION SHOWS
DIVERGING TRENDS IN CORPORATE GOVERNANCE*

CORY HOWARD¹

¹ J.D. Candidate Class of 2014, Wake Forest School of Law. The author would like to thank Sara White, without whose support this article would not have been possible, as well as the editors and staff at the Richmond Journal of Global Law and Business.

I. Introduction

Due to the recent global financial crisis, shareholders, voters, and politicians in North America and Western Europe have become increasingly concerned with the issue of executive compensation. New regulations, such as say-on-pay shareholder votes, tax incentives to reduce base salary, and hard caps on bonuses have been enacted in an attempt to slow the exponential growth in the value of executive compensation packages in the both the United States and Europe. This trend is not limited to developed nations, as in other regions, most notably in Asia, executive pay has risen dramatically, oftentimes with little or no oversight by government institutions or formal regulatory bodies. This article attempts to track how nations in different regions of the world regulate executive compensation and tries to extrapolate from that sample general tendencies in order to detect broader corporate governance trends. Using this methodology, this article identifies two basic trends: (1) one hemisphere is enacting strict legal mechanisms to control executive compensation, while the other relies on self-regulation and (2) one region is using executive compensation reform to open up access to the corporate governance arena for small investors, while the other is attempting to limit shareholder democracy.

Part II of this article will explore regional trends in executive compensation, especially focusing on the transition of regulation in India and the transparency efforts in China. Part III will explore what these changes

mean to the global corporate governance movement and attempt to pin down specific trends, using the methods and laws employed by sample countries to highlight converging and diverging practices used in different regions of the world.

II. Regional Trends in Executive Compensation

American corporate executives are currently the highest paid executives in the world when comparing the ratio of their pay to that of the average company employee.² However, both Asian and European nations also struggle with rising executive compensation packages and stagnated wages for the average worker. Because of public outcry and recent developments in corporate governance scholarship, nations in both regions are, or have attempted to, impose regulations on executive remuneration, although the manners and methods they chose vary as widely as their geography.

A. Europe

1. The Move to Strict, Legal Regulation of Executive Compensation

Although many in the United States agree that executive compensation is unjustifiably high, few can agree as to what reforms should be instituted to

² Dana Ely, *Is an American CEO Worth 10 Times a British One?*, BALT. SUN, July 12, 2011, available at http://articles.baltimoresun.com/2011-07-12/news/bs-ed-ceo-salaries-letter-20110711_1_american-ceo-median-worker-salary-ratio (noting that the pay ratio for American CEO's to their employees is about 250-1, while countries such as Sweden, Germany, Japan have ratios of 13-1, 11-1, 10-1, respectively).

control it, or even who should implement such reforms.³ In Switzerland, however, voters voiced no such hesitation in a recent countrywide referendum. During this popular vote, 68% of the voters agreed to reforms such as annual say-on-pay votes, inclusion of bonus schemes and pay plans in the articles of incorporation, and a ban on severance packages.⁴ Equally telling were the methods by which the referendum proposed to enforce the new regulations, which include fines of up to six years of the director's salary and a multiple-year prison sentence.⁵

Switzerland is not the only Western European nation to enact, either through public election or through legislative decree, stricter regulation over executive compensation.⁶ Germany, for example, eliminated bonuses and placed a hard cap on compensation for executives at corporations that received

³ Cory Howard, *The Need for Federal Preemption of Executive Compensation Reform: How Corporate Governance and Economic Justice Objectives are Only Achievable Through Comprehensive Federal Regulation of Executive Compensation*, 46 U.I.P.R. REV. JUR. (2013)(FORTHCOMING).

⁴ Martin W. Lewis, *Mapping the 2013 Swiss Referendum: Executive Compensation*, GEOCURRENTS (Mar. 23, 2013, 7:38 PM), <http://geocurrents.info/geonotes/mapping-the-2013-swiss-referendum-executive-compensation>.

⁵ Raphael Minder, *Swiss Voters Approve a Plan to Severely Limit Executive Compensation*, N.Y. TIMES, Mar. 3, 2013, available at http://www.nytimes.com/2013/03/04/business/global/swiss-voters-tighten-countrys-limits-on-executive-pay.html?_r=0.

⁶ Matthew Saltmarsh, *Europe Also Moves to Limit Executive Pay*, N.Y. TIMES, FEB. 7, 2009, available at http://www.nytimes.com/2009/02/07/business/worldbusiness/07bonus.html?_r=0 (noting the limitations that Western European nations have placed on executive remuneration).

public assistance.⁷ France, too, imposed a hard cap on corporations controlled by the state.⁸ In addition to individual nations, the European Parliament and EU have negotiated a deal that would severely limit the bonuses that bank executives can receive.⁹ The recent imposition of these and similar restrictions show that European citizens, lawmakers, and shareholders are beginning to favor strict governmental regulation over executive compensation.

B. Asia

Executive compensation in Asian countries has and will continue to grow at historic rates, with some predicting that it will surpass American executive pay in the near future.¹⁰ The meteoric rise of executive pay in the region is due mostly to the shortage of executive talent, as companies are consistently pressed to find innovative individuals who are able to “take risks” and “act quickly.”¹¹ Unfortunately, this kind of demand shock in executive

⁷ *Id.*

⁸ Tara Patel, *France to Cap CEO Pay at State-Owned Companies Like EDF, Areva*, BLOOMBERG (May 30, 2012), <http://www.bloomberg.com/news/2012-05-30/france-to-cap-ceo-pay-at-state-owned-companies-like-edf-areva.html>.

⁹ Gabrielle Steinhauser et al., *EU Reaches Deal to Curb Bank Bonuses*, WALL ST. J., Feb. 28, 2013, available at <http://online.wsj.com/article/SB10001424127887323293704578330814285107262.html> (noting that the new agreement strictly limits compensation bank executives can receive, such as limiting bonuses to no more than an executive’s base salary).

¹⁰ Marlene Prost, *Asian Pay Hikes May Impact U.S. Employers*, Human Resources Executive Online (Oct. 26, 2011), available at <http://www.hreonline.com/HRE/view/story.jhtml?id=533342590> (noting that executive compensation has increased as much as 7% per annum in Asian nations)

¹¹ *Id.*

supply has and will continue to create numerous corporate governance problems for Eastern corporations.

1. The Changing of the Guard in India: From Strict Regulatory Control to the “Spirit of Corporate Governance”

Although originally tightly regulated by hard salary caps, economic liberalization in the early 1990s, increased foreign direct investment, and strong economic growth has forced Indian regulators to seriously reconsider the legal and corporate governance mechanisms used to control executive compensation. Beginning with the Companies Act of 1956 and 1988, India set and thereafter raised the maximum allowable compensation given to corporate executives until reforms during a period of economic liberalization all but eliminated the hard caps.¹² Because of this reduction in direct governmental oversight, India has increasingly relied on voluntary corporate governance practices to limit executive compensation.¹³ For example, Clause 49 of the Voluntary Guidelines on Corporate Governance, issued by the Ministry of Corporate Affairs, plays an instrumental role in shaping executive compensation packages.¹⁴ Specially, sub-section C1 speaks to the philosophical and business underpinnings of the Indian view of executive pay.

¹² Rajesh Chakrabarti et. al, *Executive Compensation in India*, in HANDBOOK ON EXECUTIVE COMPENSATION 6-7 (Randall Thomas & Jennifer Hill, eds., Edgar Elgar, 2010).

¹³ *Id.*

¹⁴ Dilip Kumar Sen, *Voluntary Guidelines on Corporate Governance - Implementation Issues*, TAXMANN (2010), [http://www.taxmann.com/TaxmannFlashes/Articles/\[2010\]102SCL00084\(MAG\).htm](http://www.taxmann.com/TaxmannFlashes/Articles/[2010]102SCL00084(MAG).htm).

Under the Voluntary Guidelines, executive pay should “be reasonabl[e] and sufficient to attract, retain and motivate directors to run the company successfully.”¹⁵

Looking at the history of corporate governance in India, one can identify a discernible trend that is at odds with the current state of corporate governance in the Western Hemisphere. As India entered into a period of economic liberalism in the 1990s and began to attract increased economic development and foreign direct investment, direct regulation was relaxed as voluntary corporate governance principles became the primary mechanism for control. This is not uncommon for developing economies, as building strong corporate governance mechanisms can help developing countries achieve productive growth, decrease the chance of a national financial crisis, increase the value of domestic corporations, and decrease corruption.¹⁶ However, many North American and Western European leaders have lost their faith in the ability of self-imposed corporate governance norms to regulate executive behavior (and compensation), most notable because of the perceived failings of the financial sector in the most recent economic downturn. At the height of the crisis, federal lawmakers attached direct regulations on executive

¹⁵ *Id.*

¹⁶ Varun Bhat, Note, *Corporate Governance in India: Past, Present, and Suggestions for the Future*, 92 IOWA L. REV. 1429, 1436-37 (2007) (noting that strengthening corporate governance institutions is of particular concern for developing nations as it enables them to reduce corruption, strengthen corporate value and increase the attractiveness of investing by foreign investors).

compensation in the Economic Emergency Stabilization Act (EESA) and the Troubled Asset Relief Program (TARP).¹⁷ The desire to exert direct governmental oversight has even reached the non-profit sector, where state governments, such as New York, have attempted to place direct caps on compensation.¹⁸ This creates a clear divergence between the Eastern and Western views of corporate governance, with India truly, albeit incompletely,

¹⁷ Michael S. Melbinger, *Executive Compensation and Risk: TARP Rules for Financial Institutions Trigger Broader Risk Assessment of Compensation Policies*, 14 N.C. BANKING INST. 59, 59-61 (2010) (explaining that corporations who were subject to the executive compensation restrictions imposed by the Treasury ensured that the loans were paid back quickly so that they would no longer have to abide by the compensation regulations); Davis, Polk & Wardwell, *New Executive Compensation Restrictions Under the Emergency Stabilization Act of 2008*, Feb. 6, 2009, <http://www.davispolk.com/files/Publication/a6b994a7-e05c-499e-98e1-b541f2df01ae/Presentation/PublicationAttachment/1ec2c380-eb2a-4dff-9051-b70302d8080f/02.05.09.ec.pdf> (listing and explaining the limitations to executive compensation that the Treasury individually negotiated with institutions who received funds via the EESA).

¹⁸ John Eligon, *Cuomo Limits State Money for Salaries of Contractors*, N.Y. TIMES, Jan. 18, 2012, available at http://www.nytimes.com/2012/01/19/nyregion/cuomo-limits-state-money-for-salaries-of-contractors.html?_r=0 (explaining that Gov. Andrew Cuomo's Executive Order limits the pay of non-profit executives, as well as for-profit executives, at companies with state contracts); Harvy Lipman, *State Efforts to Cap Non-Profit CEO Pay Drawing Attention*, NORTHJERSEY.COM (June. 25, 2012) http://www.northjersey.com/news/160206715_New_attention_directed_at_non-profit_CEO_pay.html?page=all (noting that Gov. Cuomo introduced legislation to limit the pay of non-profit executives to \$199,000 in companies that have state contracts; however, Gov. Cuomo's executive order only limits how much tax-payer money can be spent towards executive compensation of for-profit companies, which leaves those corporations free to use other income sources to bolster high executive compensation.)

embracing the “spirit of corporate governance”¹⁹ by permitting informal institutions to govern executive compensation, while Western nations have moved in unison towards strict governmental oversight.

2. China Moves Toward Transparency for Publically Traded Companies

Given the rapid expansion of the Chinese economy and its continually increasing importance to the international community, it is not surprising that China’s regulation of executive compensation has undergone tremendous overhauls in the recent millennium.²⁰ One of the most significant criticisms that has plagued Chinese executive compensation practices has been the lack of transparency of the remuneration packages that executives receive.²¹ In fact, the most significant portions of the packages are not even salaries or bonuses, but hidden payments.²² These “administrative expenses” include on-duty consumption and incentive expenditures and could potentially make up a large (and hidden) portion of a Chinese executive’s salary.²³ However, there has been a recent movement toward public disclosure of director and executive base compensation, bonuses, stipends, and benefits, which became required in

¹⁹ Bhat, *supra* note 16, at 1445-46 (explaining that the “spirit of corporate governance” is a culture of following corporate governance requirements not merely out of rote, but as part of an entrenched business ethos).

²⁰ *Does China Have an Executive-Compensation Program?*, TIME: BUSINESS & MONEY (May 21, 2012), <http://business.time.com/2012/05/21/does-china-have-an-executive-compensation-problem/>.

²¹ *Id.*

²² *Does China Have an Executive-Compensation Program?*, *supra* note 19.

²³ *Id.*

2006 for companies traded on the Shanghai and Shenzhen stock exchanges.²⁴ This regulation was a significant change from a 2001 regulation that only required disclosure of the compensation of the top-three executives and was a tremendous improvement from the pre-2001 no disclosure era.²⁵

III. Using Regional Differences in Executive Compensation Regulation to Track Diverging Trends in Corporate Governance

Having discussed a rather diverse sample of executive compensation regulations from different regions of the world, two distinct and divergent patterns become clear. First, while the United States and Western Europe are using the global financial crisis to enact stricter legal regulations on executive compensation, Eastern nations, such as India, are beginning to rely more and more on informal norms to control executive compensation. Second, while China is taking steps to increase shareholder participation (including steps to make it easier for small investors to participate), academics in the West, including U.S. and European scholars and business leaders, are increasingly vocal about limiting shareholder democracy.²⁶

²⁴ Martin J. Conyon & Lerong He, *Executive Compensation and Corporate Governance in China*, 17 J. CORPORATE FIN. 1158, 1160 (2012).

²⁵ *Id.*

²⁶ See Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1575 (2006) (noting that over- and improper use of shareholder democracy has left it an empty concept in the corporate governance); Sofie Cools, *The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697, 745 (2005) (noting that shareholder power in the U.S. is weak).

A. Opposite Enforcement Regimes

The author of the Swiss referendum specifically cited the need for a “broader and tougher clampdown” on executive compensation after the global financial crisis exposed major failures in Swiss corporations.²⁷ This kind of strong governmental oversight on a hot-button corporate governance issue is a radical departure from the atmosphere of self-regulation that was pervasive in the 1990s.²⁸ The global financial crisis exposed serious flaws in self-governance, and the move towards stricter regulation shows that government leaders, shareholders, and citizens have grown impatient seeing firms “incapable of regulating themselves according to the codes they have subscribed to.”²⁹ By relying on a “spirit of corporate governance,” Indian lawmakers are increasingly placing the burdens of best practice implementation and compliance on the corporation, without any subsequent strengthening of governmental authority or oversight. There is a strong push in India, as well as other developing countries, to strengthen self-regulation, as it is seen as a primary method for establishing lasting corporate governance policies.³⁰ Even in the face of corporate scandals and egregious failures in

²⁷ Minder, *supra* note 5.

²⁸ CENTRE FOR EUROPEAN POLICY STUDIES, CORPORATE GOVERNANCE REFORMS IN THE EU 1 (2009), http://www.ceps.eu/system/files/prosp_corporate_governance_TF.pdf (noting that nations within the EU traditionally let corporations police themselves on matters of corporate governance in the mid-1990s.)

²⁹ *Id.*

³⁰ *Self-Regulation Stressed for Healthy Corporate Governance*, HINDU BUSINESS LINE, Nov. 28, 2012, available at

self-regulation, such as the Enron and Tyco debacles, and the behavior of large financial institutions in the recent global financial crisis, Indian policymakers continue to urge for less governmental control over corporate activities. This move away from strict, centralized government regulation of corporate practices could be the result of one, or a combination of several different factors. As Asian economies begin to compete with American and European firms for talent and opportunities, they want to insure that strict control over corporate activity does not make their firms less attractive for foreign investors.³¹ Additionally, there is some backlash to the export of Western notions of corporate governance, as critics have called them a “Trojan Horse” for imposing neocolonial values.³²

<http://www.thehindubusinessline.com/economy/self-regulation-stressed-for-healthy-corporate-governance/article2668837.ece> (noting that the Third International for Conference for Corporate Governance in Asia stressed the need for self-regulation as the best path for sustainable corporate governance practices and policies).

³¹ Ira M. Millstein, *Corporate Governance Reform in Asia*, CORPORATE GOVERNANCE ADVISOR (Jan./Feb. 1999), available at <http://www.weil.com/news/pubdetail.aspx?pub=3231> (noting that Asian firms want to remain attractive to foreign investors, which could explain a lack of incentive for governments to impose strict regulations).

³² *Id.* (noting the potential reasons for Asian resistance of Western, which typically include strict government regulations, of corporate governance.)

B. Moves Toward and Away from Active Participation in Corporate Governance

China has continually taken strides to make executives' compensation packages more transparent and to reduce the role of hidden remuneration.³³ This is an especially important advancement in corporate governance as it reduces monitoring costs and allows small shareholders to take an active role in corporate governance.³⁴ By moving towards transparency, the Chinese government is removing prohibitive entry costs to the corporate governance marketplace, effectively allowing not just institutional investors, but also small shareholders, to become active.³⁵ This therefore strengthens shareholder democracy and forces managers to be attentive to all shareholders.³⁶

Increasing the voice of smaller investors in the corporate governance arena, however, is the opposite of what is taking place in the United States.³⁷

³³ See Guanghua Yu, *The Regulation of Executive Compensation in China*, (Univ. Hong Kong, Working Paper, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1535660.

³⁴ *Id.* (noting that transparency for executive compensation packages reduces monitoring costs which permit otherwise small, passive investors to become involved in the corporate governance process).

³⁵ *See id.*

³⁶ *See id.*

³⁷ See Richard Agnich & Steven F. Goldstone, *What Business Will Look for in Corporate Law in the Twenty-First Century*, 25 DEL. J. CORP. L. 6, 19-20 (1999) (recognizing the limits of shareholder democracy and the need for a "group of elders" to guide businesses). See generally Martin Lipton, *Important Questions about Activist Hedge Funds*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE & FINANCIAL REGULATION (Mar. 9, 2013), <http://blogs.law.harvard.edu/corpgov/2013/03/09/important-questions-about-activist-hedge-funds/> (noting that activist shareholders often do not have the companies best interests in mind, and therefore, the corporate governance

Famed corporate attorney Martin Lipton, as well as business leaders, have voiced their concern over giving shareholders too much power over corporate affairs.³⁸ Legal scholars who advocate for increased shareholder rights are currently in the minority, and critics quickly counter most academic proposals to strengthen shareholder democracy.³⁹ Many see the secondary market for securities and the investors' ability to sell their shares freely as the only necessary source of shareholder power, and that policymakers should avoid expanding shareholder power beyond this as it could threaten the health of the business.⁴⁰

IV. Conclusion

It is becoming increasingly clear that, although the global marketplace is becoming more interconnected, the methods by which its business leaders are paid varies based on geography. These regional differences do not just highlight a nation's or culture's best business practices for paying executives, but also serve as a benchmark against which one can measure progress in the

community should trust the directors and reduce the need for management responsiveness to shareholder initiatives).

³⁸ See generally Lipton, *supra* note 37.

³⁹ *Shareholder Democracy: Battling for Corporate America*, THE ECONOMIST, Mar. 9, 2006, available at <http://www.economist.com/node/5601741> (explaining that legal academics that advocate for increased shareholder power are rare).

⁴⁰ See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003) (noting that shareholder's ability to buy and sell their shares should be the only shareholder power granted and that giving shareholders additional power threatens to interfere with business operations and reduce the value of the shares and corporation).

corporate governance movement. This article asserts that differing executive remuneration strategies show that, as governments in the Western hemisphere become increasingly concerned with placing legal limits on executive pay, Eastern nations are permitting corporations to police themselves, guided primarily by “the spirit of corporate governance.” Additionally, Eastern nations are seeking to actively involve investors in the corporate governance conversation by removing costly barriers to their entry into the fray, while the United States and Western Europe are rethinking shareholder democracy.