Laughing all the way: Executive pay, company performance and corporate governance in the Australian banking industry

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ABSTRACT

The major retail banks typically dominate Australia's list of annual high net profit earners. To some commentators, this constitutes proof that the banks are well governed and that bank CEOs are justly rewarded in relation to both the responsibility and risk that they bear and the dictates of the market for 'top executive talent'. Others point out that while bank CEOs are amongst the most highly paid and wealthy of all Australian salaried CEOs, their tenure of office is relatively short, their business is high risk and highly competitive, and their ability to realise the high wealth potential of executive equity plans is constrained by increasingly onerous performance hurdles. To invoke the language of classical Agency Theory, it would seem that the boards of the major Australian banks have effectively addressed the principal-agent problem.

Yet, on closer examination, a rather different set of realities emerge. Drawing on Bebchuk and Fried's (2002, 2004) theory of 'systematic rent extraction' and using both qualitative and quantitative data, this paper examines the associations between chief executive office remuneration, board composition, corporate governance structures, executive behaviour, and bank performance in the top ten ASX-listed retail and investment banks over the past five years.

The opening section contextualises the study by providing a brief overview of the international debate about executive pay and corporate governance, along with associated conceptual insights and arguments, including those associated with rent extraction theory. The following section reveals trends in the level and composition of CEO remuneration, retention and separation payments, and draws comparisons with trends in pay rates for CSOs and other line employees in the banking workforce. Subsequent sections deal with board composition in the ten banks, ownership spread/concentration, CEO recruitment, tenure and turnover, CEO 'structural power', processes associated with CEO pay determination, the opacity of CEO employment contacts, board and CEO behaviour in relation to executive share option plans, and the use and abuse of performance hurdles as applied to short-term and long-term incentives.

As a way of gauging the degree of pay-performance 'sensitivity', the paper then compares CEO remuneration trends firstly against traditional accounting and market-related measures of company performance and then against the Economic Value Added measure of capital use efficiency. Judged against the latter criterion, the rise and rise of bank CEO pay is both performance insensitive and perverse. This unflattering finding is also considered against the backdrop of the social costs of bank executives' aggressive pursuit of profit maximisation, including the abandonment of broader social responsibilities to bank customers and staff.