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Executive Compensation & Corporate Governance

Insights 2018 – Part 2

*A study examining
compensation in
100 Swiss and 130
German companies*

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Introduction Insights 2018, part 2

PwC's *Insights 2018, part 2*, offers a comparison of the level and development of board and executive compensation (together referred to here as *top management bodies compensation*) in Switzerland and Germany. By covering around 100 companies in Switzerland (SMI, SMIM, and small-cap companies) and 130 companies in Germany (DAX, MDAX, and SDAX) for the period 2014-2017, it provides a comprehensive picture of the quantum and structure of pay in these two countries. For simplicity, we also refer to the three company size groups as big, medium, and small companies, respectively.

The key findings are:

1. In both Switzerland and Germany, top management bodies compensation increases strongly with firm size. Moreover, the median top management bodies compensation combined is generally somewhat higher in Switzerland than in Germany. Specifically, in Swiss big, medium, and small companies, the median total top management bodies compensation in 2017 amounted to CHF 36.8 million, CHF 16.0 million, and CHF 6.0 million, respectively, whereas in Germany the numbers were CHF 31.1 million, CHF 10.9 million, and CHF 4.5 million, respectively. These differences across countries have declined somewhat since 2014.
2. The median value of the executive-to-board compensation ratio – the ratio of total compensation of executives divided by total compensation of board members – is substantially higher in Germany than in Switzerland. In 2017, at the median German big, medium, and small firms, the executives as a group received 8.8, 6.6, and 8.2 times as much as the board overall. At the median Swiss firms, these numbers were 6.0, 5.0, and 4.7, respectively. This result accords with expectations, given that the Swiss “Verwaltungsrat” has a more powerful function than the German “Aufsichtsrat”.
3. Individual chairpersons and board members receive higher pay in Switzerland than in Germany. This used to be the case in the early years also for executives, but currently this is no longer true. In 2017, the median Swiss chairperson received approximately three times the compensation of his German counterpart in each of the three size buckets: CHF 1.2 million vs. CHF 361,000; CHF 626,000 vs. CHF 208,000; and CHF 330,000 vs. CHF 111,000. The median SMI CEO received approximately 80% of his German counterpart (CHF 5.5 million, compared to CHF 6.8 million), and the median CEO of Swiss small-cap firms received 87% (CHF 1.4 million, compared to CHF 1.6 million). Only CEOs of medium-sized firms received more in Switzerland than in Germany, with CHF 3.3 million compared to CHF 3.0 million. Median other executives received lower pay in all three firm size buckets in Switzerland (99%, 80%, and 67% of their German counterparts). In the prior years, executives in Switzerland tended to receive somewhat higher compensation. It remains to be seen, therefore, if the 2017 outcome will be sustained in future years as well.
4. We also analyse the chairperson premium and the CEO premium. These are largely similar in Switzerland and Germany, except in the largest firms, where the pay premium of chairpersons relative to other board members is much higher in Switzerland than in Germany. Fees for the audit committee chairperson are only modestly higher in Switzerland than in Germany, which is initially somewhat surprising but can ultimately be rationalized in the context of the roles and the compensation of other board members in the two countries.
5. The structure of executive compensation is largely similar in Switzerland and Germany. In both countries, the fraction of variable compensation is higher in larger firms. A striking difference arises, however, when it comes to shareholding guidelines: Whereas these are very common in SMI companies and exist in one-third of SMIM companies, they are still quite rare in DAX and MDAX companies. Among small companies such guidelines are hardly in use in Switzerland and Germany. Overall, the results suggest that companies need effective ways of combining compensation elements that reward steps towards the attainment of strategic goals with long-term, equity-based elements.

The Swiss and the German samples

In this study, we compare board and executive compensation in Switzerland (CH) and Germany (D). This comparison is of interest because the two labour markets are highly integrated. Moreover, although Switzerland has four official languages, two-thirds of the population have German as the first language and many (though certainly not all) of the large companies have their headquarters in the German-speaking part. The governance systems of the two countries differ somewhat (see the separate box). We refer to both the Swiss “Verwaltungsrat” and the German “Aufsichtsrat” as the “board” and the Swiss “Geschäftsleitung” and the German “Vorstand” as “executives” in this study. Indeed, one goal of this study is to see, at least by way of this anecdotal evidence, whether the differences in governance and responsibilities show in compensation practices.

For each of the two countries, we analyse data from three firm size buckets. For the Swiss sample, we use the three size groups we have traditionally employed in the studies over the last decade: The SMI (essentially the largest 20 listed companies), the SMIM (essentially the next largest 30) and the small-cap companies (essentially companies ranked 51-100 in size as measured by equity market capitalization).

For the German sample, we use the DAX (essentially the largest 30 listed companies), the MDAX (essentially the next largest 50), and the SDAX (essentially the next largest 50). In each year the study covers approximately 100 companies in Switzerland and 130 companies in Germany. For simplicity, we refer to the three groups as big, medium, and small companies. **Table 1** illustrates that the median firm in each index is of approximately equal size, although in the medium and small categories, the median Swiss firm is somewhat larger than the median German firm. There are some outliers, and the sorting into indices does not follow a pure size-based rule. Nonetheless, overall, we regard these three groups as sufficiently comparable. We also note that many boards conduct compensation benchmarking relative to the indices used here. We focus on the years 2014-2017 (though for Switzerland data for earlier years are also available). All compensation numbers are in Swiss Francs, using the average interbank CHF/EUR exchange rate for each year. Rounding to two decimals, these exchange rates were: 1.21 (2014), 1.07 (2015), 1.09 (2016), and 1.11 (2017). We generally refer to the median total compensation numbers. Details on other quantiles (such as the 25th or 75th percentiles) are available upon request.

Table 1: Equity market capitalisation (in Million CHF) of the three size groups in each country

Size	Country	Index	Number of firms	Min	Lower quartile	Median	Upper quartile	Max
Big	CH	SMI	20	9,241	16,461	29,373	48,727	260,798
	DE	DAX	30	7,301	22,003	37,512	74,165	124,657
Medium	CH	SMIM	30	2,503	5,412	7,435	9,680	20,700
	DE	MDAX	50	1,981	3,845	6,718	10,144	71,441
Small	CH	CH-SMALLCAP	50	600	1,248	1,833	2,721	6,525
	DE	SDAX	50	544	909	1,347	2,425	6,789

Key points of the Swiss and German corporate governance systems

This box summarises some of the main similarities and differences of Swiss and German corporate governance as regards the role of boards and executives in listed companies.

The Swiss “Verwaltungsrat” has, broadly speaking, greater authority and responsibility, including also strategy-setting, than the German “Aufsichtsrat”, which, primarily, has a supervisory role. Indeed, the one-tier board structure is the default for Swiss listed companies, meaning that in Switzerland the board is responsible for managing the company. However, Swiss corporate law allows for the creation of a two-tier structure, whereby the board delegates part or all transferable responsibilities to one or several board members or a management team. The board still has the non-transferable and irrevocable responsibility for the *overall* management of the company, its strategy, and its financial and risk management. However, the delegation of the *operational* management tasks is possible and a typical setup in listed companies (and many unlisted companies beyond a certain size). In contrast, Germany has a two-tier board structure with strict separation of management (“Vorstand”) and supervision of the company (“Aufsichtsrat”). A further delegation of management tasks by executives is not possible.

The “Verwaltungsrat” and “Aufsichtsrat” have some similar tasks, such as the appointment and dismissal as well as remuneration of the executives (which in Switzerland then requires a binding vote by shareholders), and the responsibility for the audit of the financial statements (which in Switzerland is then approved by shareholders) as well as the selection of an independent external auditor (which in both countries is then elected by shareholders). Nevertheless, fundamental differences in corporate governance are apparent. Swiss board members are elected annually, whereas German board members are typically appointed for a period of five years. Concerning the competence, the Swiss board is responsible for the organisation of the accounting, financial control and financial planning systems and the compilation of the annual report. By contrast, in Germany, these competences are not in the area of responsibility of the “Aufsichtsrat” but of the executives. German law provides for a strict separation of responsibility for the preparation and audit of the financial statements. Thus, the German board, especially the audit committee, has to merely monitor the accounting process, the effectiveness of the internal control system, the risk management system, and the internal accounting control system.

Comparing top management bodies compensation across countries

We begin by asking: How much does the total top management cost shareholders? To answer, we assess the levels and the development of board and executive compensation (together referred to here as *top management bodies compensation*).¹

Table 2 and **Figure 1, Panel A** show that in both Switzerland and Germany, top management bodies compensation is substantially higher in big than in small companies. Moreover, the median top management bodies compensation is generally somewhat higher in Switzerland than in Germany. Specifically, in big, medium, and small companies, the median top management bodies compensation in 2017 amounted to CHF 36.8 million, CHF 16.0 million, and CHF 6.0 million, respectively, in Switzerland, whereas in Germany the numbers were CHF 31.1 million, CHF 10.9 million, and CHF 4.5 million, respectively. This finding also holds on the executive level in each of the three size buckets, and on the board level in the largest two size groups. Only in the small-cap group do we see that median total board compensation in Germany is somewhat higher than in Switzerland. (The total compensation

amounts are a function of the number of people in each of the management bodies. Here, the focus is simply on the total cost for shareholders. We discuss individual position compensation further below.)

How has the ratio of Swiss to German compensation changed over time? To obtain insight into this question, consider **Figure 1, Panel B**. This figure plots nine ratios (three size groups times three functions (board, executives, both combined)). Strikingly, in 8 out of 9 cases, the ratio of median management bodies compensation in Switzerland compared to Germany was lower in 2017 than it was in 2014 (and much lower than it was in 2015). The one exception is median total board compensation in the largest companies, which has increased in Switzerland in the last four years, but fallen in Germany. Note that while the ratio of median total board compensation for small companies was also lower in 2017 compared to 2014, it was below one; therefore, for these companies, the difference between total board compensation in Switzerland and Germany has increased, not decreased

since 2014. Nonetheless, overall, the results imply that median top management bodies compensation in Switzerland and Germany was more similar in 2017 than it was in 2014. Specifically, in 2017 median Swiss executives overall received 1.1-1.4 times the pay of German executives, and median Swiss boards received 0.7-1.6 times the pay of German boards.

Closer examination of Table 2 reveals that the general fall in Swiss-German ratios often derives from changes in both the numerator and the denominator: In many cases, the overall fall in the ratio arose from a fall (or very small growth) in median Swiss compensation and an increase in median German compensation. For example, median total executive compensation in SMI firms was CHF 35.8 million in 2014, which fell to CHF 31.8 million in 2017 (-11.2%); by contrast, in DAX firms this number rose from CHF 21.8 million in 2014

to CHF 28.7 million in 2017 (+31.6%). The interim increase of most ratios in 2015 was mostly due to a temporary decline in median compensation in Germany.

Research conducted in Switzerland² suggests that outlier compensation levels have become much less prevalent after the Ordinance against Excessive Compensation – entailing strict binding say-on-pay – came into force in 2014. In Germany in contrast, positive economic development might explain to some extent rising median executive compensation levels. These changes can even affect the median compensation levels and may, therefore, be one reason behind the observed convergence. However, we caution that it is hard to attribute such aggregate changes to single factors. Moreover, the short period does not allow for definitive statements.

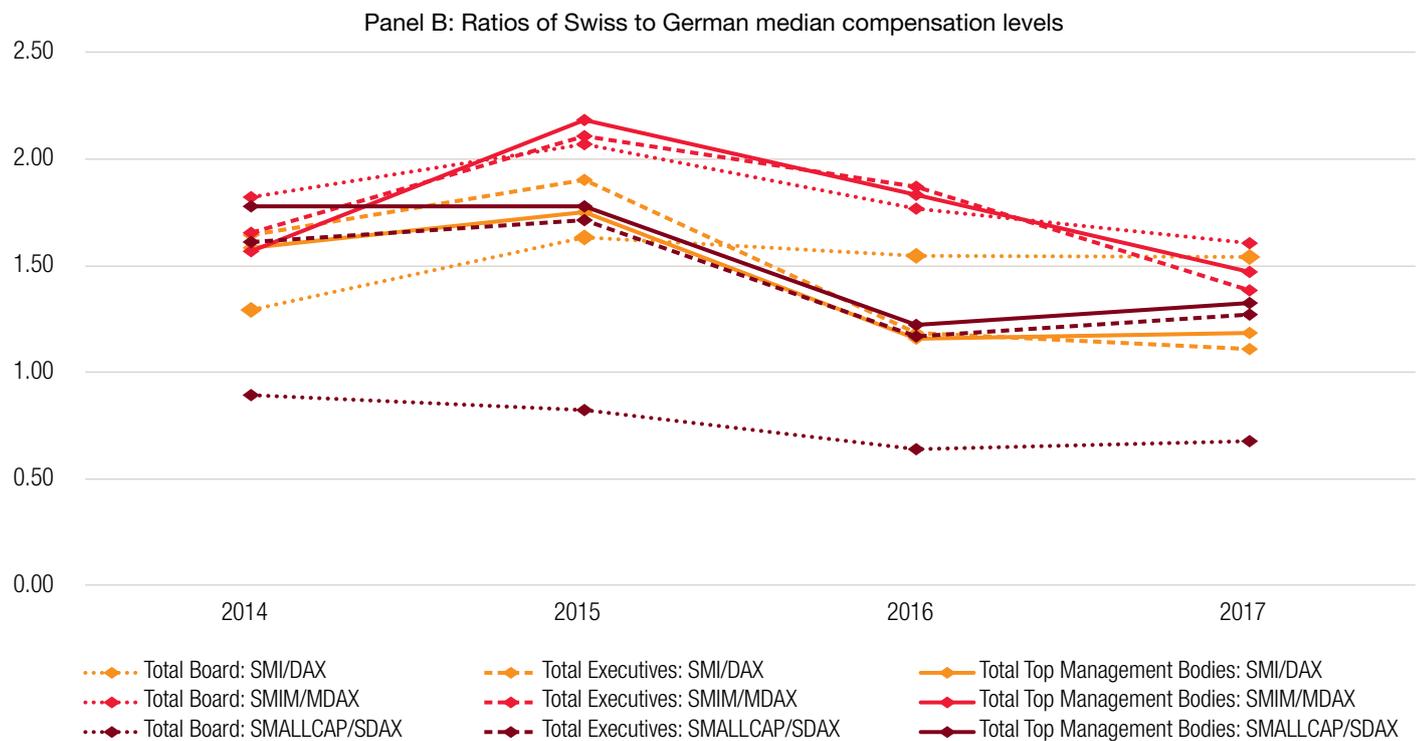
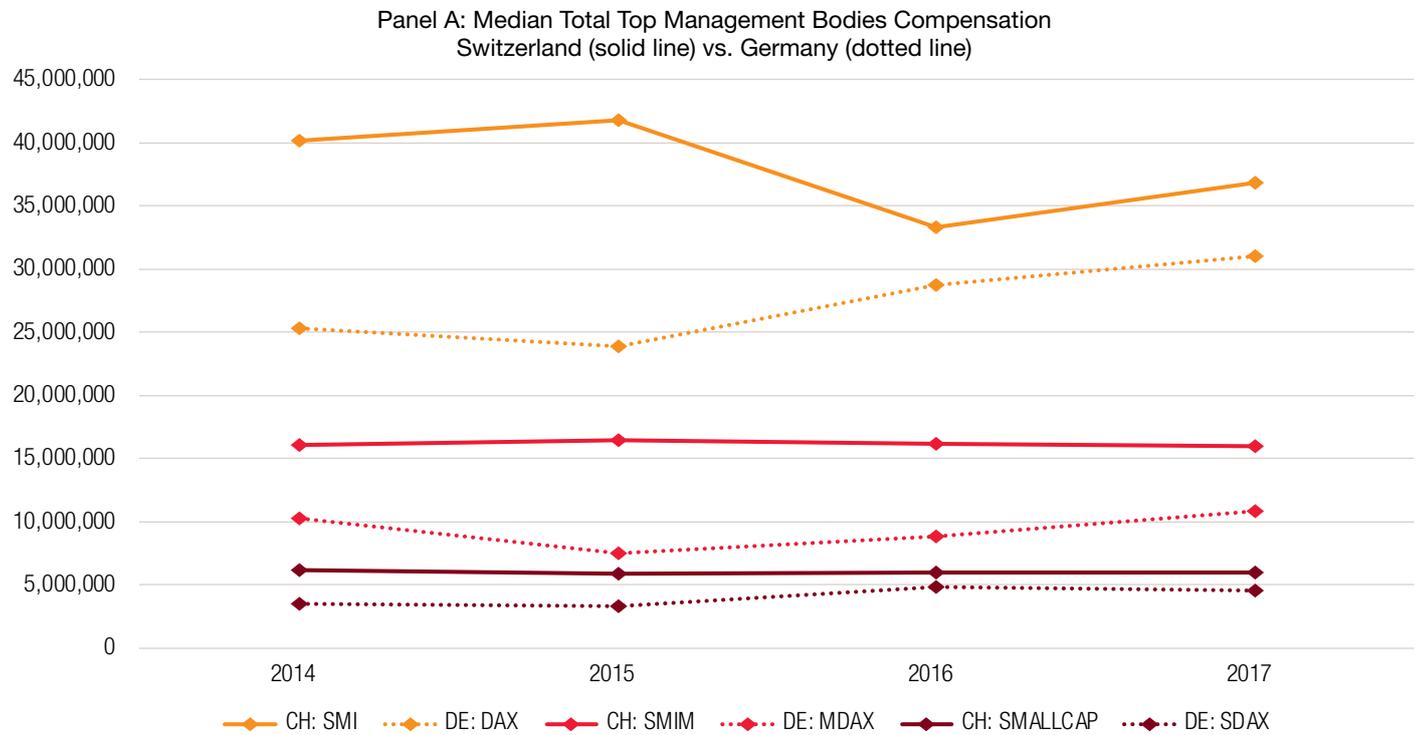
Table 2: Compensation levels for the management bodies in Switzerland and Germany

Management Body	Country	2014	2015	2016	2017
SMI & DAX					
Total Board	CH	4,191,043	4,432,209	4,372,089	4,452,434
	DE	3,246,096	2,710,875	2,824,559	2,888,756
Total Executives	CH	35,831,092	39,441,138	30,558,621	31,816,934
	DE	21,816,880	20,711,100	25,793,414	28,720,524
Total Top Management Bodies	CH	40,186,603	41,819,322	33,301,968	36,786,776
	DE	25,334,446	23,901,024	28,743,697	31,060,442
SMIM & MDAX					
Total Board	CH	2,314,000	2,312,000	2,200,919	2,036,484
	DE	1,269,287	1,115,576	1,243,248	1,267,761
Total Executives	CH	13,310,000	13,938,075	14,039,000	13,165,116
	DE	8,048,369	6,607,631	7,501,148	9,521,255
Total Top Management Bodies	CH	16,060,981	16,407,406	16,166,000	15,968,195
	DE	10,228,823	7,508,846	8,829,728	10,877,807
CH-SMALLCAP & SDAX					
Total Board	CH	691,582	723,890	688,141	699,783
	DE	774,933	881,132	1,079,930	1,038,055
Total Executives	CH	4,994,867	5,054,000	4,952,712	5,183,500
	DE	3,103,823	2,948,891	4,237,522	4,070,792
Total Top Management Bodies	CH	6,210,713	5,854,000	5,957,906	6,021,500
	DE	3,495,339	3,287,616	4,875,225	4,536,894

¹ To provide a picture of the total cost to shareholders, these numbers include compensation to leaving executives (contrary to the analysis of pay for individual positions below, which focuses on executives and board members active at the end of the fiscal year).

² See PwC Executive Compensation & Corporate Governance Insights 2015.

Figure 1: Median top management bodies compensation in Switzerland and Germany is more similar in 2017 than it was in 2014



Comparing management bodies within countries: Boards and executives

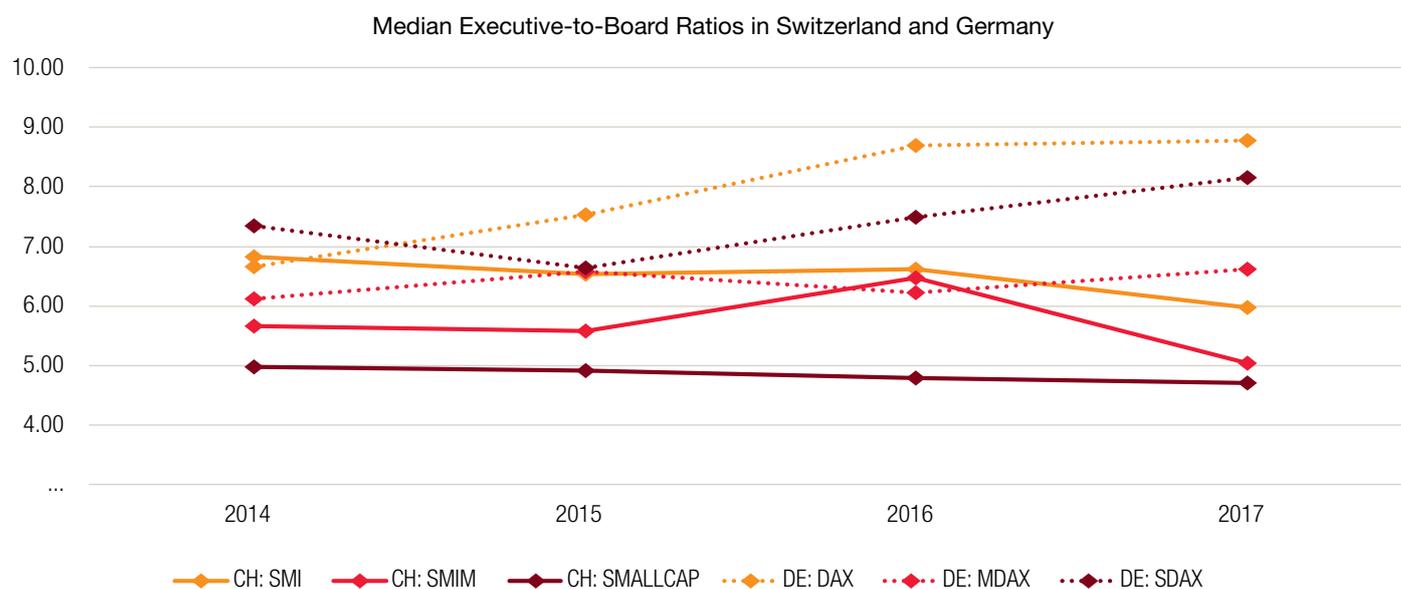
We now turn to the “Executive-to-Board” (E2B) ratio.³ The E2B-ratio can provide some indication of the balance of power between executives and board members. To the extent that compensation reflects responsibilities (and ultimately also power), one would expect the ratio to be higher in Germany than in Switzerland: After all, the Swiss “Verwaltungsrat” has a more powerful function, by law, than the German “Aufsichtsrat”.

Figure 2 provides strong support for this conjecture. Consider the year 2017. At the median German big, medium, and small firms, the executives as a group received 8.8, 6.6, and 8.2 times as much as the board overall. At the median Swiss firms, these numbers were 6.0, 5.0, and 4.7, respectively.

Interestingly, Figure 2 also shows that these ratios were closer together in earlier years and then started diverging. This result is suggested already by Table 2, where an increase in median total executive compensation in Germany occurred, in contrast to a broadly stable median total board compensation.⁴ In short, in recent years, boards in Switzerland appear to have asserted somewhat more power than in earlier years, at least relatively speaking, whereas executives in Germany have been gaining in power relative to their boards, at least as measured by their compensation.

What explains these results? One candidate reason is that executive compensation is, at least to some extent, performance-sensitive. Stronger performance by German executives could, therefore, justify the rise of their compensation relative to German board members. Is this a plausible explanation? Large German stocks have indeed performed better than the Swiss stock market in the time covered by this study. For example, the DAX offered a total return (capital gains plus dividends) of 37.4%, whereas the SMIC (the version of the SMI that includes dividends) offered a total return of 30.1% between 2014 and 2017. However, the SMIMC (the version of the SMIM that includes dividends) outperformed the MDAX (also including dividends) with 77.7% to 58.6%. At least this aggregate perspective, therefore, suggests that only part of the observed trends may be due to stronger overall performance of German executives. Anyways, there may be many, also exogenous reasons for a superior relative stock price performance of some German companies relative to Swiss ones (including, for example, the severe CHF/EUR exchange rate shock in 2015). An alternative, not exclusive interpretation highlights that a high ratio can also indicate agency problems and an ineffective set of checks and balances. As such, the findings may also point to corporate governance currently becoming somewhat stricter towards executive compensation in Switzerland than in Germany. Overall, we recommend that both Swiss and German firms be mindful of the practice they employ so they can explain it coherently to their stakeholders.

Figure 2: Executive-to-Board ratios are higher in Germany than in Switzerland – and the divergence has increased over the last four years



³ These results rely on disclosed values. For example, while most companies in Switzerland nowadays make a clear distinction between executive and non-executive roles of board members, they often do not disclose compensation separately. In such cases, we count all compensation towards the role as an executive. Thus, board pay can be understated relative to executive pay in such cases. This limitation notwithstanding, to the extent that this disclosure practice does not systematically vary across the three size groups, the analysis here can at least be considered indicative.

⁴ Note, however, that Figure 2 does not show the ratio of the medians of Table 2, but the median of the ratio of executive-to-board compensation.

Comparing individual compensation: Board members and executives

In this section, we drill down further to the compensation received by individuals in different functions. We present results for individuals active at the end of the year (excluding those who left during the year).⁵ In what follows, we refer to the Swiss-German board pay ratio as the ratio of median total compensation of Swiss chairpersons (or board members) to that of German chairpersons (or board members); and to the Swiss-German executive pay ratio as the ratio of median total compensation of Swiss CEOs (or other executives) to that of German CEOs (or other executives).

Figure 3, Panel A and **Table 3** show that in 2017, the median Swiss chairperson received approximately three times the compensation of his German counterpart, in each of the three size buckets: CHF 1.2 million vs. CHF 361,000; CHF 626,000 vs. CHF 208,000; and CHF 330,000 vs. CHF 111,000, respectively. While there was a bit of an increase in median chairperson compensation in SMI in 2015 and SDAX in 2016, compensation of chairpersons has overall remained constant. For regular board members, the Swiss-German board pay ratio is about 2 for the all three size buckets: CHF 310,000 vs. CHF 164,000; CHF 209,000 vs. CHF 98,000; and CHF 129,000 vs. CHF 56,000, respectively. It is interesting to interpret these results in light of the ratios of median total board compensation shown in Figure 1. For example, in that figure we had seen that the median board of an SMI company receives about 1.5 times more in aggregate than the median DAX board. This finding is consistent with the individual-level compensation presented in this section because Swiss boards generally are somewhat smaller than German boards: In 2017, the median (average) Swiss board in the three size groups had 11 (11.7), 8.5 (8.3), and 7 (7) members. By contrast, the numbers for Germany were 18 (16), 12 (13), and 6 (8). German boards in large and medium firms are naturally bigger than in Switzerland: According to the “Drittelbeteiligungsgesetz”, one third of the board of companies with more than 500 employees need to be employee delegates, and according to the “Mitbestimmungsgesetz”, in companies with more than 2000 employees, 50% of the board need to be employee delegates. This explains why higher individual board compensation in Switzerland does not lead to higher total board compensation to the same extent.

Consider now the executive pay ratios, derived from median total compensation of individual executives. Figure 3, Panel B presents a perhaps surprising result: In 2017, Swiss CEOs in large and small firms received, at the median, lower pay than their German counterparts. Other executives were paid less in all three size groups in Switzerland. Specifically, the median SMI CEO received total compensation of CHF 5.5 million, whereas the median DAX CEO received CHF 6.8 million; the median other SMI executive received a bit less than CHF 3.6 million in Switzerland, and a bit more than CHF 3.6 million in Germany. Similarly, the CEO and median other executive of Swiss small-cap firms received CHF 1.4 million and CHF 700,000, compared to CHF 1.6 million and CHF 1 million of their respective German counterparts, respectively. CEOs of medium-sized firms did better in Switzerland than in Germany, with CHF 3.3 million compared to CHF 3.0 million, but other executives at these firms earned more in Germany (CHF 1.8 million) than in Switzerland (CHF 1.4 million). Panel B of Figure 3 illustrates these results.

Two further comments are in order here. First, four years ago, the median SMI CEO had still earned 14% more than the median DAX CEO; today, it is 20% less. As such, the striking 2017 results are due to the growth of executive compensation in Germany, and the stability or decrease in executive compensation in Switzerland since 2014. But even absent these more recent developments, the Swiss-German executive pay ratio has never been nearly as big as the board pay ratio. Second, the fact that in 2017, the median total executive compensation was higher in Switzerland than in Germany (see Table 2) even though median individual executive compensation tended to be higher in Germany, can again be explained by the size of the respective groups. In 2017, the median (average) Swiss executive board in the three size groups had 11 (10.8), 7.4 (7.7), and 5 (5.7) members. By contrast, the numbers for Germany were 7 (7), 4 (4), and 3 (3).

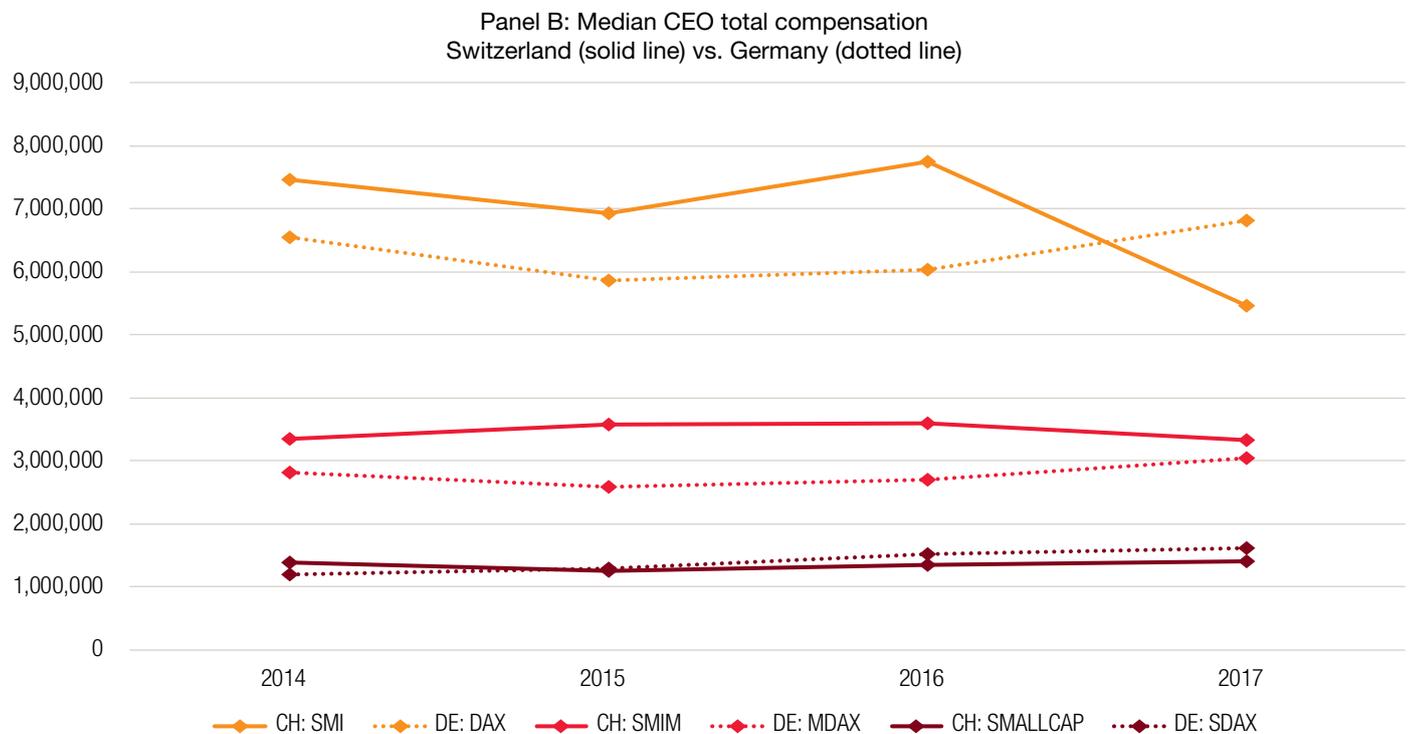
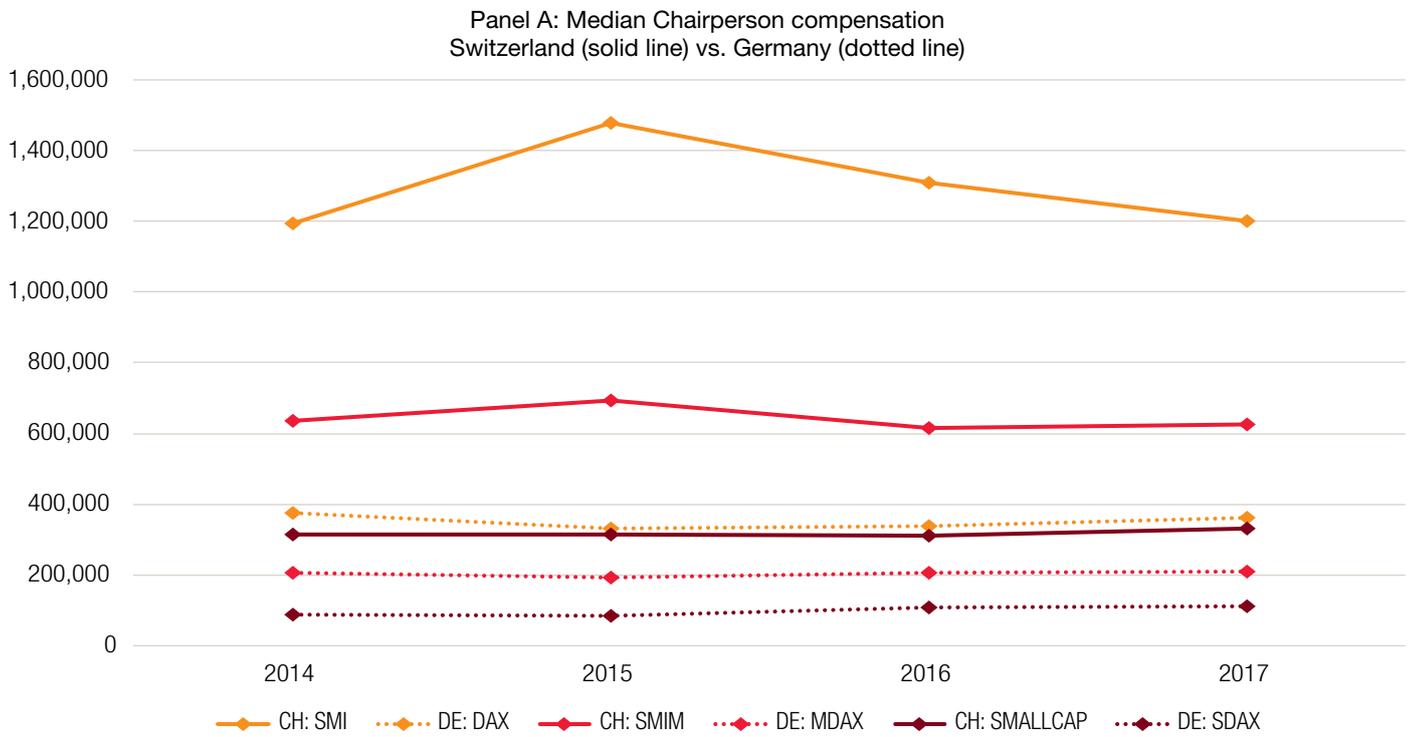
⁵ An alternative approach is to restrict attention to individuals active for the full year. That approach has the advantage that potentially unrepresentative values (due to short service periods during a year or large initial replacement awards for prior compensation) are not included; it has the disadvantage that the sample is smaller. All results remain largely similar with the alternative approach (details are available on request).

Table 3: Relatively stable chairperson compensation, more dynamics in CEO compensation

Median Pay	Country	2014	2015	2016	2017
SMI & DAX					
Chairperson	CH	1,193,238	1,479,125	1,310,469	1,200,494
	DE	374,531	332,184	338,473	361,260
Other Board Members	CH	307,620	309,668	300,150	309,903
	DE	170,516	134,100	151,022	163,865
CEO	CH	7,453,575	6,932,919	7,746,511	5,464,441
	DE	6,543,183	5,861,483	6,030,587	6,812,065
Other Executives	CH	3,371,294	3,619,228	3,549,962	3,565,279
	DE	3,521,183	3,048,933	3,194,244	3,614,824
SMIM & MDAX					
Chairperson	CH	635,399	694,470	615,000	626,142
	DE	204,058	190,658	206,936	208,419
Other Board Members	CH	208,120	223,000	212,000	209,496
	DE	97,252	83,646	93,225	97,596
CEO	CH	3,345,444	3,573,124	3,592,500	3,320,000
	DE	2,819,154	2,588,042	2,692,380	3,039,031
Other Executives	CH	1,799,667	1,589,838	1,659,868	1,413,000
	DE	1,640,964	1,451,942	1,555,013	1,755,335
CH-SMALLCAP & SDAX					
Chairperson	CH	314,625	313,367	311,176	329,938
	DE	86,239	85,449	109,009	111,157
Other Board Members	CH	121,000	120,400	125,900	129,341
	DE	50,529	46,783	54,068	55,877
CEO	CH	1,376,291	1,242,829	1,354,204	1,401,109
	DE	1,191,551	1,291,351	1,514,135	1,611,776
Other Executives	CH	691,582	723,890	688,141	699,783
	DE	774,933	881,132	1,079,930	1,038,055

Ratios of CH to DE Median Pay	Country	2014	2015	2016	2017
SMI & DAX					
Chairperson	CH/DE	3.19	4.45	3.87	3.32
Other Board Members	CH/DE	1.80	2.31	1.99	1.89
CEO	CH/DE	1.14	1.18	1.28	0.80
Other Executives	CH/DE	0.96	1.19	1.11	0.99
SMIM & MDAX					
Chairperson	CH/DE	3.11	3.64	2.97	3.00
Other Board Members	CH/DE	2.14	2.67	2.27	2.15
CEO	CH/DE	1.19	1.38	1.33	1.09
Other Executives	CH/DE	1.10	1.09	1.07	0.80
CH-SMALLCAP & SDAX					
Chairperson	CH/DE	3.65	3.67	2.85	2.97
Other Board Members	CH/DE	2.39	2.57	2.33	2.31
CEO	CH/DE	1.16	0.96	0.89	0.87
Other Executives	CH/DE	0.89	0.82	0.64	0.67

Figure 3: Relatively stable chairperson compensation, more dynamics in CEO compensation



The chairperson and CEO premiums

Table 4 looks at how the agenda-setting and decision-making power inside a management body translates into pay. That is, for each company, we compute the ratio of the compensation of the chairperson of the board relative to the average compensation of the other board members; and the compensation of the CEO relative to the average compensation of the other executives.⁶ We then report the medians of this “chairperson/CEO-to-other” (C2O) ratio in each of the size groups.

The analysis shows that the chairperson premium, that is, the difference between the compensation of the chairperson and other board members, is particularly pronounced in SMI companies, at 3.81, relative to 2.22 in DAX companies. In the other firms, the C2O ratio is somewhat, though not much higher in Switzerland than in Germany. Overall, there is some modest evidence suggesting that Swiss chairpersons and CEOs are more powerful than their German counterparts (or more able to convince the board and shareholders that their position entails more responsibility or requires more skills and, therefore, higher compensation).

Table 4: Chairs of top management bodies receive a somewhat higher median premium (ratio of compensation relative to average non-chairs) in Switzerland than in Germany

Median of "C2O" Ratios	Country	2014	2015	2016	2017
SMI & DAX					
Chairperson vs. Other board members	CH	3.74	4.35	4.33	3.81
	DE	2.37	2.27	2.28	2.22
CEO vs. Other executives	CH	2.33	1.96	2.42	2.04
	DE	1.92	1.79	1.89	1.86
SMIM & MDAX					
Chairperson vs. Other board members	CH	2.14	2.09	2.39	2.48
	DE	2.29	2.21	2.06	2.16
CEO vs. Other executives	CH	1.96	2.23	2.00	1.97
	DE	1.68	1.65	1.56	1.69
CH-SMALLCAP & SDAX					
Chairperson vs. Other board members	CH	2.51	2.50	2.41	2.53
	DE	1.96	1.96	1.98	2.03
CEO vs. Other executives	CH	1.82	1.78	1.87	1.87
	DE	1.53	1.59	1.51	1.40

⁶ The academic literature has particularly worried about the CEO pay slice. However, also chairperson compensation can provide an indication of a skewed power balance.

Audit committees

The audit committee plays a very important role in corporate governance. Accurate accounting is essential both internally and externally: Internally, accounting numbers drive strategic and operational decisions, and they are often relevant for contractual compensation outcomes. Externally, investors need to be able to rely on reporting to allocate funds most efficiently. But accounting is not only important; it is also fraught with difficult choices and potential conflicts of interest. For example, whether and how to allow for certain discretionary accruals can be vexing. When questions regarding the legitimacy and correctness of accounting arise, this can be highly problematic for the reputation of a company. In both Switzerland and Germany, the executives – especially the CFO – will be in the focus of attention initially. In Switzerland in addition the board’s responsibility, in particular the audit committee’s responsibility will also move quickly into focus. By contrast, in Germany, the accounting committee is merely responsible for monitoring the accounting process and the auditing of the financial statements, besides other tasks (see also „Key points of the Swiss and German corporate governance systems”). Competent and critical external auditors, of course, also play an important role, but in general, they cannot substitute for a strong audit committee.

Inside the audit committee, naturally, the chairperson plays the most important role. Therefore, in this section, we analyse their compensation. **Table 5** shows that fees for the chairperson are somewhat higher in Switzerland than in Germany: In Swiss large, medium, and small companies, the median fee (that is, the additional amount paid for chairing this committee) was CHF 95,000, CHF 50,000, and CHF 25,000, respectively. In Germany, the numbers were CHF 89,000, CHF 39,000, and CHF 17,000, respectively.⁷ In Switzerland, the median was somewhat, but not much, higher in earlier years whereas in Germany, the median committee fees tended to rise. Overall, the Swiss numbers are higher, but it is noteworthy that the difference is not proportional to the usual pay difference between Swiss and German boards.

Recall from Table 3 that the median regular board member gets paid 89%, 115%, and 131% more in Switzerland than in Germany, depending on the company size group; by contrast, the audit committee chairperson fees are higher only by 7%, 29%, and 50%. This result is initially puzzling, also in light of the fact that at least in principle, the Swiss “Verwaltungsrat” is responsible for the design of the organization of the framework for accounting, financial control, financial planning, and for the preparation of the annual report, both of which do not fall (to the same extent) under the responsibilities of the German “Aufsichtsrat”. It is possible that the relatively low fee for Swiss Audit Committee chairpersons and the relatively higher overall pay level for other board members jointly reflect the collective responsibility of the Swiss board.

Table 5: Median audit committee chairperson compensation is slightly higher in Switzerland than in Germany

Median audit committee chairperson	Fee 2017	Total compensation 2017
SMI & DAX		
CH	95,000	400,000
DE	88,926	214,505
SMIM & MDAX		
CH	50,000	187,500
DE	38,905	127,647
CH-SMALLCAP & SDAX		
CH	25,000	129,800
DE	16,674	73,919

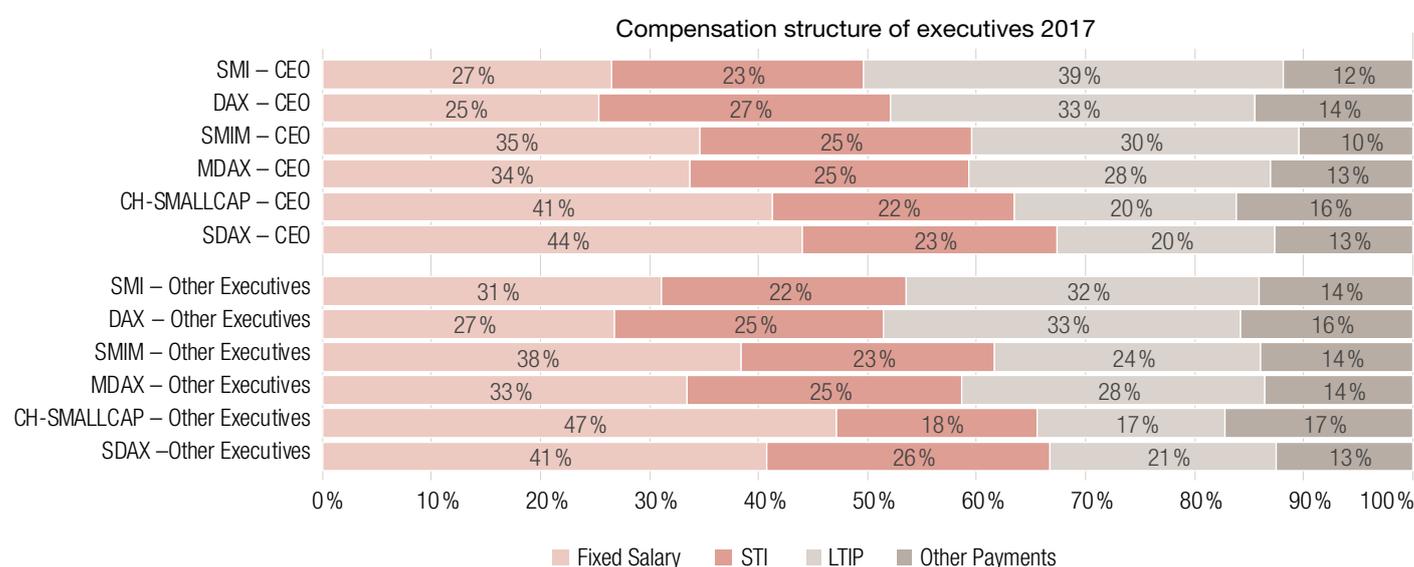
⁷ Of course, when denominated in Euros, the numbers are round in Germany as well, namely, EUR 80,000, EUR 35,000, and EUR 15,000, respectively.

Structure of executive compensation and incentives

Finally, we compare the structure of compensation and in particular the alignment with shareholder value embedded in the compensation principles. **Figure 4** considers the average CEO and other executive compensation structures in 2017. Straightforward results arise. First, overall the compensation structures are quite similar in Switzerland and

Germany. Second, larger companies provide more variable compensation. Whereas in small companies, base salary plus other compensation makes up around 60%, in large companies, that fraction is about 40%. Third, Swiss CEOs tend to receive a larger fraction as long-term oriented compensation, but for other executives, the ratios are similar in Switzerland and Germany.

Figure 4: The executive compensation structure is similar in Switzerland and Germany



To ensure alignment with shareholder interests, it is, of course, not enough to merely convey compensation in the form of share-based payments. If long-term incentive plans are ultimately settled in cash, as is typically the case in Germany, the long-term alignment with firm value is unclear. Shareholding guidelines provide a potentially useful complement to the ongoing compensation. Interestingly, such guidelines are still not widely used in Germany at the moment. Table 6 shows that only 27% of DAX companies use such guidelines for their CEOs and other executives, whereas 70% of SMI companies do so. Only 12% of MDAX companies have such guidelines for their CEOs; 33% of SMIM companies have them. Among small-cap companies, such guidelines are, so far, quite rare in both Switzerland and Germany. Typically, companies define the requirements in terms of fractions of base salary (often around 200% for CEOs, and somewhat lower for executives).

About a fifth of the large companies in both Switzerland and Germany have shareholding guidelines also for their board members, and some Swiss medium companies have such guidelines for their non-chair board members. None of the medium or small German companies discloses shareholding guidelines on the board level.

Table 6: CEO Shareholding guidelines are more common in Switzerland than in Germany

	Share of Firms with Shareholding Guidelines 2017	Median Multiple of Base Salary for Shareholding Guidelines 2017
SMI & DAX		
CH	70%	300%
DE	27%	200%
SMIM & MDAX		
CH	33%	200%
DE	12%	200%
CH-SMALLCAP & SDAX		
CH	2%	n.d.
DE	4%	150%

Conclusion

Overall, these results show – once again – that common wisdom regarding board and executive compensation needs to be challenged now and then. Some observers have highlighted the higher pay of board members in Switzerland, but the fact that pay levels of executives in the two countries are quite similar has received far less attention. By and large, where differences between Switzerland and Germany exist in the relative levels of board and executive compensation, they can be traced back to differences in the governance systems. In both countries – and in others – the design of effective compensation systems is a challenge. To drive this discussion forward, *Insights 2018*, part 3, released in November 2018, presents a new idea for linking equity-based (long-term) compensation with a focus on the achievement of strategic targets. This versatile method can be adjusted to the circumstances of each firm but is sufficiently general to allow straightforward communication to shareholders and other stakeholders.



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