On Executive Comp, the Swiss Aren't Neutral — Will the U.S. Be Persuaded?

TIME
By Helena Bachmann
March 7, 2013

For more than a century, the Swiss have managed to stay out of conflicts and wars. But when it comes to excessive corporate compensations, they are hardly neutral.

Last Sunday, 68% of Swiss voters accepted a groundbreaking proposal that would require shareholders to approve the pay of executives and board members of public companies. The result of the controversial nationwide referendum reverberated around the world because it set radical new rules for corporate governance that could spill over to other countries.

Several nations already allow shareholders to have a say on executive compensation, and the E.U. agreed last week to cap bankers' bonuses at twice their salaries. In the U.S., the Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in 2010, requires all public corporations to seek a nonbinding shareholder approval of executive compensations. But Switzerland's new legislation will be by far the most strict because the "say on pay" will be compulsory rather than optional, and noncompliance will carry heavy fines and even prison sentences.

The supporters of the initiative are thrilled — especially Thomas Minder, a businessman who spearheaded the referendum by collecting 100,000 signatures required by the Swiss system of direct democracy to bring an issue to a nationwide vote. However, the opponents, including the business lobby, fear that giving such sweeping powers to shareholders and imposing harsh penalties for failure to conform to the new law will prompt multinational firms headquartered in the country to leave, affecting Switzerland's ranking, by the World Economic Forum, as the world's most competitive nation. Switzerland is home to numerous large companies, including food giant Nestlé, mining company Glencore and pharmaceutical firms like Novartis and Roche.

Despite some concerns over the future of the country's economy when the law goes into effect sometime in 2014, Switzerland's standing will not be significantly affected, predicts Stephane Garelli, a professor at the IMD business school in Lausanne and a leading expert on competitiveness of nations. "Only public companies quoted on the stock exchange are impacted," he notes. "As for the very large ones, we can assume that top-management remunerations will be paid globally and not only in Switzerland. Therefore, the attractiveness of Swiss companies should remain intact."

The concern arising in American boardrooms is different: whether this groundbreaking legislation will be contained within Switzerland and Europe, or set a new precedent for corporate compensation and bonuses in the U.S., where, according to a 2011 study by consulting firm Towers Watson, top executives make 269 times more than average workers.

But, despite an ongoing debate in America over growing income inequality and exorbitant CEO compensations, analysts say that Swiss-like change — if it sweeps the U.S. at all — will not happen overnight.

“This may take some time,” says David R. Koenig, CEO of the Governance Fund Advisors in Northfield, Minn. “Change comes very slowly in the United States, because entrenched entities — boards of directors and the executives — benefit from the current system.”

This analysis strikes a chord with Stephen Davis, associate director of the Harvard Law School Programs on Corporate Governance and Institutional Investors. “The vote will be seen as a warning signal to U.S. boardrooms, but the odds of binding votes on pay are remote.”

Still, “reverberations from the Swiss vote could put fresh momentum into shareholder rebellions in the U.S,” he adds. “The Dodd-Frank legislation imported the European practice of ‘say on pay’ to curb excessive CEO compensation, and evidence shows that investors are wielding it. The Swiss vote could further gird their determination.”

Robert Jackson Jr., associate professor at Columbia Law School and an expert on executive compensation, also believes that “the Swiss precedent will give the advocates important ammunition if they choose to press the U.S. Congress to adopt binding ‘say on pay’ rules here.”

However, like Koenig and Davis, he says that change, if it does occur, will not be immediate. “American regulators have preferred to wait and see how those changes play out in Europe before pursuing them here,” he notes.