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CEO Pay Ratios Are In. Here's What We've Learned So Far.

Most public companies have disclosed their CEO pay ratio, and we have several key findings that could be useful for shareholder engagement and planning for next year.

The first year of CEO pay ratio disclosures are in for most public companies and there are several key findings that will be helpful as companies think about how this new data could be used by stakeholders in the future.

Not surprisingly, we found pay ratios are heavily influenced by company characteristics. As we explained in our article *The Story of How We Helped One Client Put Their CEO Pay Ratio into the Right Context*, a company's industry, location of workforce, business model and size all heavily influence the CEO pay ratio figure.

As seen in Figure 1, the energy, transportation, banking and utilities industries— where fewer employees tend to be located outside of the United States— have lower pay ratios. Similarly, industries that rely heavily on overseas manufacturing have higher ratios. Non-US employees can be excluded only if they are from countries where privacy laws may prevent the company from complying with the rules or in cases where non-US workers make up 5% or less of the total employee population.

Among the technology and life sciences sectors, the software industry has the lowest median CEO pay ratio at 84. Healthcare equipment is the highest at 169, but still well below consumer services' companies with a median pay ratio of 370.

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Figure 1

Median CEO Pay Ratio by Industry

Industry	Count	Median Pay Ratio
Consumer Services	32	370
Retailing	76	298
Household & Personal Products	8	248
Automobiles and Components	13	246
Food, Beverage & Tobacco	26	171
Healthcare Equipment & Services	59	169
Food & Staples Retailing	7	164
Consumer Durables & Apparel	43	152
Media	27	148
Pharmaceuticals, Biotechnology & Life Sciences	36	133
Capital Goods	117	118
Technology Hardware & Equipment	40	111
Insurance	50	104
Commercial & Professional Services	32	96
Materials	81	94
Telecommunication Services	12	93
Diversified Financials	45	90
Semiconductors	20	90
Software and Services	84	84
Energy	98	71
Real Estate	60	62
Banks	85	60
Transportation	30	57
Utilities	52	55

Note: The data presented above includes Russell 3000 companies in Aon's Compensation and Governance Professional (CG Pro) tool as of May 22, 2018.

If we look at the technology and life sciences sectors by company size, larger companies clearly have higher CEO pay ratios. This isn't surprising as CEO pay is highly correlated with the size of the organization; however, company size doesn't have the same influencing factor on pay for non-executives. Larger companies are also more likely to have foreign operations and roles in lower-cost locations.

Figure 2

Median CEO Pay Ratio by Company Size: Technology

Revenues	Median Ratio	Median CEO Pay	Median Employee Pay
Greater Than $20B	288	$17,871,923	$79,233
$10B to $20B	280	$13,603,489	$76,449
$5B to $10B	249	$10,778,838	$65,006
$1B to $5 billion	181	$7,115,614	$71,805
Less than $1B	84	$4,467,112	$79,376

Source: Aon's Compensation and Governance Professional (CG Pro) tool

Figure 3

Median CEO Pay Ratio by Company Size: Life Sciences

Revenues	Median Ratio	Median CEO Pay	Median Employee Pay
Greater Than $20B	364	$17,026,721	$74,657
$10B to $20B	301	$13,899,373	$81,726
$5B to $10B	242	$11,173,890	$65,767
Up to $5 billion	167	$6,804,063	$71,646

Source: Aon's Compensation and Governance Professional (CG Pro) tool

Alternative Calculations

The SEC's disclosure rules allow companies to also provide an alternative ratio in addition to the required pay ratio. Only about 10% of the companies in our database chose to provide an alternative ratio. In these instances, the companies' median alternative ratio was 25% lower than the required ratio. Most often, companies excluded one-time equity awards from the calculations or excluded non-US employees.

The methodology for determining the median employee is determined by each company, either by using the actual median employee or statistical sampling. Companies are also allowed to apply a cost-of-living adjustment to the actual total compensation of the median employee. Very few companies in our analysis reported using statistical sampling or applied a cost of living adjustment. At this point, organizations don't appear to be seeing a benefit from the extra work required to use these two adjustments.

Who is the Audience for the Ratio?

Investors, proxy advisors and analysts are often viewed as the primary audience for any disclosure required in the proxy statement. However, with the CEO pay ratio, proxy advisors Institutional Shareholder Services (ISS) and Glass Lewis, as well as most major institutional investors, haven't issued any formal voting policy based on the pay ratio disclosures. And while the media has reported on some eye-catching CEO pay ratios from certain high-profile or local companies, by and large, pay ratios have flown under the radar.

Many of our clients are most concerned about how their employees perceive the ratio. We believe there are two key groups of employees who are the most likely to be discouraged when the required pay ratio is publicly disclosed: those at a company who find themselves closer to the median than they would have expected, and those who fall well below the median. If an employee believed they were well compensated and they find out the median employee makes more than them, they may not feel that way anymore. Without some basic education provided to employees about how salaries, merit increases and incentive payouts are determined— and how they differ among job roles, responsibilities, geographies— some employees will inevitably make comparisons about their pay vs. the median. If companies don't get in front of the narrative around how compensation is determined and the overall pay philosophy, employees may develop their own narrative that differs from the company's. For more information about how to tell your compensation story, please see our article *The Era of Pay Transparency is Here. Is Your Organization Prepared?*

Looking Ahead

We recommend companies take the following steps in the off proxy season as they debrief from the first year of pay ratio disclosures:

1. **Gather intel**. Review how your ratio compares with your peer group and be prepared to discuss this with investors during the off season. Be aware that in the second year of disclosures there could be more focus on comparing how a company's own ratio has changed year-over-year and identifying the underlying drivers of the change in the ratio.

2. **Monitor proxy advisory firms**. While ISS and Glass Lewis don't have formal processes in place on how they evaluate CEO pay ratios, we can't rule out that they will make policy changes in the off season or that they won't evaluate companies' ratios next year on a year-over-year comparison basis.

3. **Focus on internal messaging**. Understand the factors that influence your ratio and median compensation figure so you can develop messaging around this to your employees.

To speak with a member of our executive compensation consulting group about the CEO pay ratio rule or other topics, please write to consulting@radford.com. To learn more about participating in a Radford survey, please contact our team.

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