

Reciprocity at the top table: Progress on boardroom pay

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Reciprocity at the top table

Progress on boardroom pay

1. Current state of executive pay in the UK

The focus of this pamphlet is not on the pay of the chief executive officers of the average UK company, many of whom are not necessarily well remunerated and have often founded their businesses, but on the pay of the leaders of the UK's largest companies.

In the first three days of 2018 Britain's top executives had taken home more than the average UK worker earned in the whole of the previous year, according to High Pay Centre and CIPD calculations.

In 2016, FTSE100 Chief Executives earned on average 120 times more than the average total pay of their employees, taking home £3.45 million compared to £28,758.⁽¹⁾

A generous estimate – assuming that CEOs work 12 hours a day, with very few holidays⁽²⁾ – would render this level of pay equivalent to a rate of over £898 an hour. Contrast this with the current “national living wage” for over 25s of just £7.50 an hour.

Indeed, across the last thirteen years, the median pay package of Britain's top bosses rose by a staggering 82%!⁽³⁾

According to recent research from Lancaster University, the huge increases in top pay in the last few years are largely due to so-called ‘performance-related’ bonuses. However, the link between executive pay and company performance has in fact been “negligible”, with rises in executive pay signalling little in the way of “meaningful” economic profit for their company.⁽⁴⁾

Last year, the top City fund manager Standard Life and leading investment management company Blackrock spoke out about current levels of executive pay at the UK's largest companies. The former stated it “could not justify” pay going any higher, while the latter urged CEOs to ensure that any increases in salary for executives did not outpace those for average workers.⁽⁵⁾⁽⁶⁾ The Chief Executive of Blackrock, Larry Fink, added that his company would vote against “misaligned executive compensation”.

Remarking on the problem of unfair pay differentials, High Pay Centre director Stefan Stern said: “While it was encouraging to see a tiny amount of restraint on pay at the top of some FTSE100 companies last year, there are still grossly excessive and unjustifiable gaps between the top and the rest of the workforce.

Publishing pay ratios will force boards to acknowledge these gaps. We look forward to working with business and government to make this new disclosure requirement work as effectively as possible.”⁽⁷⁾

2. How excessive high pay and rewards for failure came to flourish

Excessive pay and rewards for failure are symptomatic of what is wrong with the way our economy has been operating over the last 30 years – of how wealth is created, how opportunities are shared, how success is rewarded, and how power is exercised in our companies.

At the heart of progressive politics lies the belief that we are all mutually dependent. Better together. Stronger together.

Likewise, business and society are not separate islands - they are mutually dependent. Business needs a strong society, providing it with human resource, talent and custom. A strong society needs everything that productive business can offer: the jobs, the growth, the innovation, the opportunities, the wealth creating potential. That is why we should take an interest in the pay issue.

Having a skill that is in short supply but high demand is likely to be well rewarded in the marketplace. And as the size of some markets has increased – to become continental and in some cases genuinely global – so have the rewards to those at the top.

Of course it is not easy to chart a successful course for a major corporation, where the contours of the market place can change rapidly, where new competitors are around every corner, and where new technologies can make an entire business model obsolete overnight. It takes special skill and extraordinary commitment. So no one is against success that rewards this merit and application. Success should be rewarded.

However, increasingly, what we have seen is something else. Reward that is not linked to success or performance: a self-perpetuating spiral of remuneration for those in the golden circle. Frequently we see handsome rewards for failure. Rewards that seem quite unbelievable to the vast majority of people in this country.

Since the 1980s there has been a move to create an entrepreneurial culture among executives at the top of our large corporations, but it hasn't delivered for our economy or business itself. The owners of the company – the shareholders – entrust executives with substantial powers to make far-reaching decisions about the running of the company. Oversight is difficult, because those involved in the day to day management have plenty of discretion and a large information advantage. How can shareholders ensure their agents, the directors – the

executive directors in particular - act consistently in those shareholders' best interests? The solution was to try to align the incentives – through bonuses, shares, share options, incentive plans and the like, using different mechanisms and over different time frames.

But it is hard to create a true entrepreneurial culture among executives at the top of a large corporation. Entrepreneurs have most of their own money on the line when they make decisions; executive directors of large companies do not. The result has been that the value of incentive packages for executives has risen out of all proportion to improvements in company performance.

And as rewards at the top have become disproportionate to company performance, so rewards for executives have become disconnected from the rest of the workforce. They are no longer just the best paid employees. More and more, they are becoming a class apart.

In the three decades to 1979, executive pay grew 0.8% on average. As we have seen, across the last thirteen years, the median pay package of Britain's top bosses has seen an increase of 82%.⁵ It has now reached a point where it is "damaging the interests of British business in political, economic and reputational terms".⁽⁸⁾

3. Why greed in the board room is bad for business, the economy and society

The discussion should start by asking what we pay people for? We pay people to do a job and, where they do so successfully, people do not object to them enjoying the fruits of their success; it is right that those who work hard, generate wealth and create jobs for our country are rewarded.

However, where failure is rewarded or people award themselves huge pay rises that bear no relation to performance, trust is severely undermined. As President of the CBI, Paul Dreschler CBE said earlier this year, "good corporate governance is an essential ingredient for trust between business and society"⁽⁹⁾ – without which economies and societies cannot flourish.⁽¹⁰⁾ He continued, "executive pay has become a lightning rod for public discontent."

Similarly, Peter Cheese, Chief Executive of the Chartered Institute of Personnel and Development commented: "Current levels of executive pay undermine both trust and sustainability. Fiddling around the edges of the current system won't provide the solutions we need for an innovative, productive and leading economy."⁽¹¹⁾

Bad for business

If exorbitant incentive packages ever worked, it seems that there are now declining returns. In the first decade of this century FTSE 350 firms increased their pre-tax profits by 50% and their earnings per share by 73%, while year-end share prices fell by 5%. Over the same period, bonuses for executives in these companies have risen by 187%, long term incentive plans by 254%. Similarly, in 2016 Lancaster University Business School found the evidence of a relationship between executive pay and company performance to be negligible. This demonstrates what psychologists have already found – that the relationship between financial incentives and performance is far from simple, and is not even reliably positive.⁽¹²⁾

At the same time, the heavy focus on the alignment of high powered incentives risks crowding out other, more rounded but equally powerful intrinsic motivations of executives that are just as relevant to the company's success – the satisfaction of doing a good job, the pride in leading and growing a great company, of winning in the market place, of having the respect of peers, of creating a legacy of sustained and sustainable success.

Indeed, the former Secretary of State for Business, Innovation and Skills, Sir Vince Cable MP, has commented on the practice of benchmarking executive pay across major companies, stating that there was an “utter narcissistic obsession with pay among the top Chief Executives”, branding the practice “a foolish, counterproductive activity”.⁽¹³⁾

Will Hutton makes similar observations, suggesting that “these "super-salaries" have ... everything to do with CEOs keeping up with each other in a status race” and that the remuneration levels of those in an executive's social network is one of the best determinants of their pay.⁽¹⁴⁾

These assessments lend weight to the view that an excessive focus on pay can often be to the detriment of other, perhaps more important, concerns regarding the company's performance. People are not opposed to performance-related pay in itself, but it does make you wonder: if a company is so concerned that an executive paid only their salary won't be motivated to work hard in the best interests of the company, then maybe they have the wrong person in the job? At its worst you end up with perverse incentive structures which encourage the wrong kind of decision making, as the failures in many financial institutions in the wake of the 2008/9 financial crash so clearly illustrated.

Indeed, the High Pay Centre and the economist Mariana Mazzucato note that the focus on short-term financial performance measures (such as quarterly profits and share price) in executive pay packages can encourage executives to cut costs and investment, thereby increasing profits and share price in the short-term.⁽¹⁵⁾

Or, to the same end, executives may commit to speculative mergers and acquisitions, and/or share buybacks. Mazzucato points out that Fortune 500 companies spent \$3 trillion in the decade to 2013 on buying back their own stock. These policies have a two-fold effect: exacerbating existing inequality, channelling money away from areas key to the interests of the vast majority of employees – “whose rewards are linked to investments in the productive economy” – and toward the 1% whose rewards are linked to stock price movements⁽¹⁶⁾; in this way, withdrawing money from areas such as research and staff development which are vital in bringing about longer-term growth can have adverse long-term consequences for companies. As the High Pay Centre observe, “BP attempted to cut costs on its US drilling rigs, but ended up with a \$100 billion bill in the aftermath of the Deepwater Horizon disaster”.

Finally, overemphasising the importance of the contribution of those at the top can undermine the motivations of others in the business. There is a growing body of research that confirms that just as relative rewards matter as a basis for social comparison among executives, so they matter to other employees too. A 2015 survey of employees by the CIPD found that 60% thought CEO pay levels demotivated employees.⁽¹⁷⁾ They matter for employee engagement, and their sense of identification with company goals. Feelings of unfairness in pay reduce the willingness to cooperate, can reduce effort and weaken commitment. Unsurprisingly, greater pay inequality in a firm has been found to be associated with lower firm performance.

So excessive pay and rewards for failure are undoubtedly bad for business.

Bad for the economy

Outlandish executive pay in the financial sector has drained talent from other sectors, distorted the market and unbalanced our economy. Entrepreneurs, those running our small businesses, are the lifeblood of our economy, providing approximately two thirds of private sector jobs and almost half of private sector turnover. We need people to take risks and set up these businesses. But why would they do so if they can earn excessive wealth in the boardroom and the City? This level of remuneration, with rewards disproportionate to success, has made the challenge of rebalancing the economy – by region as well as by sector – harder.

In addition, ballooning executive pay across the board has helped to promote inequality. The economist Thomas Piketty argues in his seminal work, *Capital in the Twenty First Century*, that “the primary reason for increased income inequality in recent decades is the rise of the supermanager.”⁽¹⁸⁾ There is a huge

body of research to show that substantial levels of inequality have a detrimental impact on the economy and on society.

The International Monetary Fund published a research paper back in 2014 which supported the analysis of Nobel Prize winning economist Joseph Stiglitz that greater inequality leads to shorter and more volatile spells of economic growth and more frequent and severe boom-and-bust cycles. The IMF also suggested that states with high levels of inequality suffered lower growth more generally than those which distributed incomes more evenly. It concluded that reducing inequality and promoting more sustained economic growth may be ‘two sides of the same coin’.⁽¹⁹⁾

Furthermore, the former Chief Economist at the IMF, Raghuram Rajan, argues in his book ‘Fault Lines’ that rising inequality in the United States contributed to the financial crisis.⁽²⁰⁾ Rajan suggests that it was the high levels of wage inflation for the top earners, while wages stagnated for the rest of the population, which led to a growth in easy credit.

In essence, in an attempt to assuage discontent with stagnant pay and rising job insecurity for the many, government increased the supply of money to the banking sector – making it easily available for public lending with lower interest rates – in order to encourage lending to households, especially those on low-incomes. This, in turn, would maintain their ability to consume (in the short term) – which, it was hoped, would mean “they [would] pay less attention to their stagnant monthly paychecks.”

However, as Rajan states, “when easy money pushed by a deep-pocketed government comes into contact with the profit motive of a sophisticated, competitive, and amoral financial sector, a deep fault line develops.”

Bad for society

Likewise, inequality – as expressed by the pay differential between a FTSE 100 company executive and its median worker – has profound negative consequences for society. It inhibits social mobility, creating a new aristocracy of the superrich whose privileges “perpetuate themselves over generations”. Indeed, according to findings presented in the ‘The Spirit Level’, the USA has less social mobility than many poorer countries.⁽²¹⁾

The authors Wilkinson and Pickett also suggest that people have a deep-seated psychological tendency to equate outward wealth with inner worth; inequality, therefore, provokes feelings of superiority and inferiority, dominance and subordination, which in turn alters the way we relate to and treat one other. Subsequent studies have demonstrated that such insecurities about social status and others’ perception of us can have powerful effects on stress, cognitive

performance and emotions. Higher rates of child abuse can be associated with higher levels of inequality⁽²²⁾, and the increased status competition prevalent in countries where socioeconomic differences are larger is likely to explain the higher rates of bullying confirmed in schools there.⁽²³⁾

Similarly, there is growing evidence that a sense of unfairness at work is an important risk factor for poor physical and mental health⁽²⁴⁾. Specific studies have now asserted that income ranking is a better predictor of developing illness than absolute income. Further, in highly unequal societies, health and social problems – including mental illness, drug addiction, obesity, and imprisonment – are up to 10 times as common. According to Wilkinson and Pickett, “the differences are so large because inequality affects such a large proportion of the population.” This observation was echoed by one of the foremost researchers in this area, Harvard University Professor Ichiro Kawachi, who has described the ‘pollution’ effects of income inequality on society.⁽²⁵⁾

4. Details of the original recommendations of the High Pay Commission ⁽²⁶⁾

The High Pay Commission produced in 2011 a report on how to manage high pay. This report contained twelve recommendations, divided into three themes: transparency; accountability; and fairness.

Transparency

1. Simplify executive pay so executives receive a basic salary:

The HPC argued that Pay packets for those at the top of companies have become overly complicated, with more sophisticated rewards trying to link pay to performance. The HPC believes this complication damages relations with shareholders and encourages confusion and obfuscation.

The HPC therefore recommended that executives should, like the rest of their workforce, receive a basic salary, determined by a remuneration committee. It suggested that this remuneration committee would be able to decide to award an additional performance-related element, if deemed necessary in the long-term interests of the company.

The HPC recommended that these reforms should initially be encouraged through a revision in the UK Corporate Governance Code. In the event that these changes were not then implemented as normal practice across the FTSE, it would recommend a change in legislation.

2. Publish an anonymised list of the pay packages of top 10 executives outside the boardroom

The report argued this could be implemented through the UK Corporate Governance Code, or, if it were not, then this proposal may require legislation.

3. Standardise remuneration reports

The HPC said that remuneration reports have become overly complicated, making it increasingly difficult to compare reports across companies.

It therefore advocated a standardised form for remuneration reports, stating the Financial Reporting Council (FRC) should work with companies and other key stakeholders to design it.

The HPC stressed that it was important that the template for the standardised form include:

- a figure for the total remuneration received and a methodology for calculating this
- standardised headings
- ‘hidden’ benefits – the most significant being pensions
- a fair pay report (see recommendation 11).

4. Require fund managers and investors to disclose how they have voted on remuneration issues

The HPC proposed that, as transparency in this area varies widely, all investment funds should disclose how they have voted on all issues of corporate governance, including executive remuneration.

Accountability

5. Employee representation on remuneration committees

Because remuneration committees remain a closed shop, with many made up of current or recently retired chief executives – which the HPC argues has contributed to the dramatic growth in top pay -, the report argued that there should be employee representation on remuneration committees.

It also suggested that appropriate training and support be made available to any employee sitting on the remuneration committee.

The HPC recommended this change was implemented by encouraging companies to include employees on remuneration committees voluntarily, with the threat of legislation or fines should they not do so.

6. All publicly listed companies should publish a distribution statement

All publicly listed companies should publish annually a statement of the distribution of their income over a period of three years, showing percentage change from previous years.

The distribution statement ought to include:

- total staff costs
- company reinvestment
- shareholder dividends
- executive team total package
- tax paid.

The purpose of this measure would be to ease comparison over a number of years.

7. Advisory forward-looking vote on remuneration reports

The HPC recommended that companies should take a vote on the remuneration arrangements for the three years to come after the vote, covering future salary increases, minimum bonus awards, on-target bonuses and maximum bonus awards, as well as current hidden benefits such as pension provisions.

8. Improve investment in talent pipeline

The HPC recommended that firms ought to seek to recruit from within where possible, while retaining the option of external recruitment. Such a move, it was suggested, could be encouraged through soft schemes and encouraging best practice with an annual award for the best training programme.

In addition, the report proposed that publicly listed companies should publish in their annual report how they nurture talent.

9. Advertise non-executive positions publicly

However, when it comes to positions on company boards as non-executive director, the recruitment process should be published publicly.

The purpose of this reform would be to increase diversity on boards, make the appointment of non-executive directors more transparent and open, and reduce the closed shop mentality of appointments.

Fairness

10. Reduce conflicts of interests for remuneration consultants

The HPC argued that all companies should publish the extent of services provided by their remuneration consultants.

11. Produce fair pay reports

The report advocated published company pay ratios, from a company's top paid employee to company median over a period of three years.

12. Establish a permanent body to monitor high pay

Finally, the HPC recommended that the government should establish a permanent body to monitor top pay. This should, the HPC goes on, produce an annual report on the state of pay and have access to HM Revenue & Customs data on pay and other currently inaccessible sources.

According to the HPC's report, this permanent body should:

- monitor pay trends at the top of the income distribution
- police pay codes in UK companies
- ensure company legislation is effective in ensuring transparency, accountability and fairness in pay at the top of British companies
- report annually to government and the public on high pay.

Due to the HPC's concerns that only the voices of shareholders are heard in relation to pay, it recommended that this permanent government body should assess public opinion annually.

5. Details of the extent to which the Coalition Government of 2010-2015 delivered on the HPC's recommendations

The Coalition Government made a series of amendments to the law in this area, however this was not in response to the HPC's report.

Prior to the report, in September 2011, the Department for Business, Innovation and Skills published a discussion paper on executive remuneration.⁽²⁷⁾ This paper

covered some of the same topics focussed on by the HPC, including: transparency; the role of shareholders and the remuneration committee; and the structure of executive remuneration. It formed the basis of the reforms introduced as part of the Enterprise and Regulatory Reform Act 2013 – I led for the Opposition in taking the legislation through Parliament.

The Enterprise and Regulatory Reform Act 2013

The Act amended the Companies Act 2006, providing for quoted companies to be bound by shareholder votes on directors' remuneration policies – that is, bonuses and performance-related elements as distinct from actual pay – although votes on this were to be only advisory. It also required the policy to be set out in companies' directors' remuneration reports.

The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013

The Enterprise and Regulatory Reform Act 2013 was then followed by a series of further amendments to the Companies Act 2006, as set out in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013⁽²⁸⁾. This established a binding vote on pay policies (at least once every three years) for shareholders of 'quoted companies'⁽²⁹⁾ and an annual advisory vote on the actual pay awards made to directors under the shareholder-approved pay policies. Pay policies include information on how each director will be paid, how pay is linked to different levels of performance, and the policy on recruitment and exit payments. It must also elaborate how the pay and conditions of employees were taken into account when setting the policy and if – and how – employees were consulted on it.

It also introduced greater clarity in the reporting of executive pay in the form of an Annual Remuneration Report, which requires companies to set out how their pay policy has been applied across the previous financial year. Specifically, it must: report the pay of each director in a single figure and set out clearly how the payments relate to the company's performance; report the performance measures that had to be met in order for bonuses to be paid, subject to an exemption for measures considered commercially sensitive; and provide a comparison of the change in pay for the CEO and the wider workforce.

This then would be subject to the advisory approval (by simple majority vote) of shareholders. In the event that a majority of shareholders reject the report, then the company must put forward a pay policy, to be ratified by binding vote, at the AGM the following year.

These provisions have also been adopted as part of the UK Listing Rules, which are enforced by the Financial Conduct Authority, meaning that the regulations apply to companies that are listed but not registered in the UK.

In addition, companies with a Premium Listing⁽³⁰⁾ on the London Stock Exchange fall under the supplementary guidance on executive pay policies and awards expressed in the UK Corporate Governance Code. In particular, the Code states that executive pay policies and awards should be transparent, promote the long-term success of the company and be sensitive to pay and employment conditions in the wider workforce.

Since the 2013 reforms to executive pay, shareholders of most quoted companies have voted to support their company's pay policies and annual remuneration reports, with, on average, 93% of them voting in favour. So far only one company's shareholders have rejected in a binary vote its pay policy, and six companies have lost advisory votes on their remuneration reports.

It is noteworthy, however, that an average of 28% of shareholders of FTSE 100 companies are not exercising their shareholder voting rights and are therefore choosing to avoid expressing an opinion on the executive pay arrangements of their company.⁽³¹⁾

In summary, while the Coalition Government to some extent implemented similar reforms to those outlined by the HPC – particularly in respect of standardising remuneration reports and instituting shareholder votes – it was not as a direct result of their report, but rather as a follow-up to their 2011 discussion paper, and they made little progress on issues such as employee representation on remuneration committees and external, impartial oversight of high pay.

6. Commitments given in the manifestos of the 3 main parties, UKIP and the Greens in respect of executive pay at the 2015 and 2017 General Elections

Labour Party

2015: “We will improve the link between executive pay and performance by simplifying pay packages, and requiring investment and pension fund managers to disclose how they vote on top pay. And we will make sure employees have a voice when executive pay is set by requiring employee representation on remuneration committees”.

2017: “We will require firms supplying national or local government to meet the high standards we should expect of all businesses: paying their taxes, recognising trade unions, respecting workers' rights and equal opportunities, protecting the environment, providing training, and paying suppliers on time. We will expect

suppliers to reduce boardroom pay excesses by moving towards a 20:1 gap between the highest and lowest paid”.⁽³³⁾

“Labour will also legislate to reduce pay inequality by introducing an Excessive Pay Levy on companies with staff on very high pay”.⁽³⁴⁾

Conservative Party

2015: The Conservative Party’s [2015 manifesto](#) did not mention executive pay.

2017: “The next Conservative government will legislate to make executive pay packages subject to strict annual votes by shareholders and listed companies will have to publish the ratio of executive pay to broader UK workforce pay. Companies will have to explain their pay policies, particularly complex incentive schemes, better. We will commission an examination of the use of share buybacks, with a view to ensuring these cannot be used artificially to hit performance targets and inflate executive pay.”⁽³⁵⁾

Liberal Democrats

2015: We will also consult on requirements for companies to conduct and publish a full equality pay review, and to consult staff on executive pay.⁽³⁶⁾

Strengthen worker participation in decision-making, including staff representation on remuneration committees, and the right for employees who collectively own 5% of a company to be represented on the board.⁽³⁷⁾

2017:

“Extend transparency requirements on larger employers to include publishing the number of people paid less than the living wage and the ratio between top and median pay.”⁽³⁸⁾

“Encourage employers to promote employee ownership by giving staff in listed companies with more than 250 employees a right to request shares, to be held in trust for the benefit of employees.

Strengthen worker participation in decision-making, including staff representation on remuneration committees, and the right for employees of a listed company to be represented on the board. We will change company law to permit a German-style two-tier board structure to include employees.

Reform fiduciary duty and company purpose rules to ensure that other considerations, such as employee welfare, environmental standards, community benefit and ethical practice, can be fully included in decisions made by directors and fund managers.

Reduce the reporting requirement for disclosure of shareholdings to 1% in order to increase transparency over who owns stakes in the biggest companies.

Require binding and public votes of board members on executive pay policies.”⁽³⁹⁾

7. Conservative Government action since 2015 General Election on executive pay and the extent to which this goes beyond HPC recommendations

Since the 2015 General Election, the government has indicated its desire to implement further reform to executive pay, corporate governance and employee representation on company boards. It is worth noting that all notable government remarks on this subject have come since Theresa May became Prime Minister in July 2016.

At the launch of her campaign to become leader of the Conservative Party and Prime Minister, Theresa May said the following about employee representation on boards:

“And I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and – as we have seen time and time again – the scrutiny they provide is just not good enough. So if I’m Prime Minister, we’re going to change that system – and we’re going to have not just consumers represented on company boards, but employees as well.”⁽⁴⁰⁾

In the same speech, Theresa May said the following regarding binding votes on pay:

“I want to make shareholder votes on corporate pay not just advisory but binding. I want to see more transparency, including the full disclosure of bonus targets and the publication of “pay multiple” data: that is, the ratio between the CEO’s pay and the average company worker’s pay. And I want to simplify the way bonuses are paid so that the bosses’ incentives are better aligned with the long-term interests of the company and its shareholders.”

When speaking to the G20 on 5 September 2016, the Prime Minister said:

“To restore greater fairness, we will bring forward a consultation this autumn on measures to tackle corporate irresponsibility – cracking down on excessive corporate pay and poor corporate governance, and giving employees and customers representation on company boards.”⁽⁴¹⁾

However, in her speech to the Confederation of British Industry on 21 November 2016, the Prime Minister backtracked on her commitment to ensure workers were appointed to company boards, saying:

“First, while it is important that the voices of workers and consumers should be represented, I can categorically tell you that this is not about mandating works councils, or the direct appointment of workers or trade union representatives on boards.

“Some companies may find that these models work best for them – but there are other routes that use existing board structures, complemented or supplemented by advisory councils or panels, to ensure all those with a stake in the company are properly represented. It will be a question of finding the model that works.

“Second, this is not about creating German-style binary boards which separate the running of the company from the inputs of shareholders, employees, customers or suppliers. Our unitary board system has served us well and will continue to do so.

“But it is about establishing the best corporate governance of any major economy, ensuring employees’ voices are properly represented in board deliberations, and that business maintains and – where necessary – regains the trust of the public.”⁽⁴²⁾

She also mentioned in this speech that the government would soon publish its plans “to reform corporate governance, including executive pay and accountability to shareholders, and proposals to ensure the voice of employees is heard in the boardroom.”

This took the form of a Green Paper, published on 29 November 2016 by the Department for Business, Energy and Industrial Strategy, which sought views on a number of possible changes to executive pay and corporate governance for quoted companies, in five areas:

1. Shareholder voting and other rights
2. Shareholder engagement on pay
3. The role of remuneration committees
4. Pay disclosure
5. Long-term pay incentives

The stated objective of any reforms adopted following this Green Paper would be to strengthen the connection between executive pay and performance, and to deliver executive pay which is “long term, fair and transparent”.⁽⁴³⁾

Following the consultation on its Green Paper, the Government announced on 29 August 2017 that it would take forward three reforms in the area of executive pay:

1. Corporate Governance Code – invite the Financial Reporting Council to revise the Corporate Governance Code in the areas of (i) shareholder opposition to executive pay; (ii) responsibilities of remuneration committees; and (iii) minimum vesting and post-vesting holding periods for executive share awards.
2. Secondary legislation – introduce secondary legislation to require quoted companies (i) to report annually the ratio of CEO pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year; and (ii) to provide a clearer explanation of potential outcomes from complex, share-based incentive schemes.
3. Public register - invite the Investment Association to maintain a public register of listed companies encountering shareholder opposition to pay awards of 20% or more, along with a record of what these companies say they are doing to address shareholder concerns.

See next page for a table assessing the extent to which the High Pay Centre's recommendations have been implemented by government.

Simplify executive pay so executives receive a basic salary



Publish an anonymised list of the pay packages of top 10 executives outside the boardroom



Standardise remuneration reports



Require fund managers and investors to disclose how they have voted on remuneration issues



Employee representation on remuneration committees



All publicly listed companies should publish a distribution statement



Advisory forward-looking vote on remuneration reports



Improve investment in talent pipeline



Advertise non-executive positions publicly



Reduce conflicts of interests for remuneration consultants



Produce fair pay reports



Establish a permanent body to monitor high pay



8. Measures taken in other advanced economies in respect of executive pay since the original HPC report

European Union

In April 2014, the European Commission proposed to amend the Shareholder Rights Directive (Directive 2007/36/EC) to introduce, as part of a wider package of reform, a “say on pay”: it argued that there is an insufficient link between executive pay and performance, and that current models of ‘performance-related’ incentives in fact encourage harmful short-termism and excessive risk-taking. The EC’s proposals required companies to provide comprehensive information on their remuneration policies and how they were implemented. They did not stipulate a binding cap on executive pay levels, but necessitated a binding shareholder vote to approve pay policies – which would have to include a maximum level of executive remuneration. In addition, the proposals required pay policies to: explain how it contributes to the long-term interests and sustainability of the company; explain how the pay and employment conditions of employees of the company were taken into account when setting the policy; justify the ratio between average employees and executive.⁽⁴⁴⁾

Australia

In 2011, Australia brought in a “two-strike” rule whereby, in the event that in two consecutive years more than 25% of shareholders voted against the remuneration report, shareholders would be asked to vote on a motion which, if passed by 50% or more of the eligible vote, would require the company’s directors to stand for re-election.

France

The French Government’s proposed new law on executive pay, including an annual binding shareholder vote on the variable elements of pay - which is tied to companies’ annual performance - has been approved by the National Assembly and Senate. It is awaiting final approval from the Constitutional Council.

The Netherlands

Reforms in 2014 built on existing law requiring shareholder approval for a change in executive pay policy. Pay policies must now also be shared with employee councils, who can express any concerns at general meetings. Following the changes, shareholders are also able to claim back performance based pay if it turns out that it was erroneously awarded.

Switzerland

In March 2013, Switzerland voted in a referendum for constitutional amendments tackling executive pay. Specifically, the reforms passed in 2014 gave shareholders a binding vote on all elements on executive pay – fixed and variable – and required shareholders of listed companies to elect remuneration boards.

United States

The 2010 Dodd-Frank Act mandated a variety of rules since adopted by the Securities and Exchange Commission (SEC) in relation to executive pay. One rule adopted in 2011 required an advisory vote on executive pay by shareholders at least once every three years. This vote was only on the overall compensation package, not on specific elements within it. Another rule adopted in 2015 requires medium and large public companies to disclose the ratio of CEO pay to median employee pay.

9. Recommendations

The national debate on executive pay in the UK's largest companies is often polarised between those who believe it is not the role of the state to intervene in what should be determined by the market, and those who believe that executive pay in the private sector should be capped at some arbitrary figure set by the Government. Neither approach will necessarily ensure wages rise across the workforce.

For all the reasons outlined in this pamphlet, I believe the better course is to build a regulatory framework that links pay to the contribution made and what can be considered just and proportional in each individual case.

And there is a clear link to the need to change the UK's economic model so it is more focused on building sustainable growth in the long term. Pay incentives to deliver quick results contrary to the longer-term development of a company have become a feature of the UK business environment that constrains investment in research, skills and innovation – hampering improvements in productivity, the best way of increasing the pay of the workforce in general.

With this in mind, Government should do the following:

- 1. Implement the remainder of the of the High Pay Centre's original recommendations:** Less than half have been fully implemented and they are as valid now as they were 7 years ago.

In addition, further ideas include...

2. Put in place a regulatory framework to incentivise companies to adopt pay structures for senior executives based on long-term equity and debt holdings: The exposure of pay packages, with shares vesting over periods of at least 5 years, to the long term fortunes of the company will encourage company leaders to take a more long term view in decision making.⁽⁴⁶⁾

3. Move towards a system of Swedish style nomination committees: In the UK other board members lead on appointing new members of the board, whereas in Sweden the nomination committee is composed of the four or five biggest shareholders in the company along with the non-executive chair of the board – that same committee, composed of shareholders, also recommends the structure and amount of remuneration. This creates far stronger lines of accountability to those who ultimately own the business and would promote the shareholder activism and engagement which is key.
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4. Set up a review into the ‘absentee’ shareholder: Much of UK company law relies on shareholders to exercise their rights to police the way in which their company is run. It is all very well empowering them to do so but that will only impact if they are active with an average of 28% of shareholders of FTSE 100 companies choosing to avoid expressing an opinion on the executive pay arrangements of their company, perhaps – in part – due to greater foreign ownership of UK equity and the length of time investors hold stock reducing. Government must explore how to encourage shareholders to be more active.

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About the author

Chuka Umunna is the Labour MP for the Streatham constituency.

Born in October 1978 to a Nigerian father and English-Irish mother, Chuka grew up in Streatham and attended local schools. He studied Law at the University of Manchester and the University of Burgundy, followed by Nottingham Law School. Following his education and further training at a City law firm, he specialised as a solicitor in employment law and acted for both employees and employers for just under decade. Chuka's experience as an employment lawyer in the City, working with some of the largest and most financially successful firms in the UK, gave him first-hand exposure to the issue of executive pay.

Chuka was selected by Streatham Labour Party to be Labour's parliamentary candidate in March 2008, following the retirement of Keith Hill MP, who had served the constituency since 1992. Chuka retained the seat for Labour at the May 2010 General Election, winning 43% of the vote and becoming Streatham's first MP to have grown up in the area. He was re-elected at the 2017 General Election, with his share of the vote rising from 53% in 2015 to 68.5%.

In 2011 Chuka was appointed as Shadow Secretary of State for Business, Innovation and Skills; he left this role in autumn 2015. During this time, he sought to hold the Coalition Government to account over their business policy, and of particular importance to this pamphlet, led for the Opposition in responding to the corporate governance reforms in The Enterprise and Regulatory Reform Act 2013.

Chuka is currently Co-Chair of the All Party Parliamentary Group on EU Relations. He also sits on the advisory boards of the Centre for Progressive Capitalism and the Social Market Foundation.

Chuka was one of the speakers at the launch of the High Pay Centre in 2011.

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