high pay centre

REFORM AGENDA

HOW TO MAKE TOP PAY FAIRER

About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

The High Pay Centre was formed following the findings of the High Pay Commission. The High Pay Commission was an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK, launched in 2009.

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Contents

Executive Summary

The top pay debate

The runaway growth of top pay for corporate executives has been a vexatious issue in public debate since the Thatcher era.

Typical annual pay for a FTSE 100 CEO has risen from around £100-£200,000 in the early 1980s to just over £1 million at the turn of the 21st century to £4.3 million in 2012.[1] This represented a leap from around 20 times the pay of the average UK worker in the 1980s to 60 times in 1998, to 160 times in 2012 (the most recent year for which full figures are available).

The Coalition Government introduced new regulations in 2013, empowering shareholders with a binding veto over company executive pay policy and requiring companies to compare the percentage pay increase experienced by the CEO with that of the wider workforce.

However, analysis from the High Pay Centre suggests that these reforms have done little to bridge the pay gap between top executives and ordinary workers. Average CEO pay stood at £4.5 million for the 67 FTSE 100 companies to report pay in the three months following the introduction of the new regulations in September 2013.[2] Thus far, shareholders have not used their new powers to vote down executive pay proposals at a single FTSE 100 company.

Why is it important to address excessive executive pay?

There are a number of reasons why this should be a cause of concern for anyone interested in the UK's socio-economic wellbeing:

> Increased executive pay has led to rising income inequality, with the share of total incomes going to the richest 1% in the UK more than doubling since the 1980s.

> Increased levels of inequality in the UK mean that we have much worse poverty than other countries with ostensibly similar levels of wealth.

> Rising executive pay sets a damaging precedent for pay across other well-paid professions, driving up pay for those at the top in relation to low and middle earners, thereby exacerbating levels of inequality even further.

> Inequality is also a threat to social cohesion, undermining faith in business and heightening the appeal of more extreme political choices.

> Current levels of executive pay are unfair – they don't reflect how hard people work or the value they add. Pay is set by remuneration committees drawn from the corporate sector and financial services and then voted on by asset management professionals. These people all benefit from a culture of high pay, so have little interest in challenging it.

[1] High Pay Centre, One law for them: How big companies flout rules on executive pay, 2013, p4

[2] High Pay Centre, FTSE 100 CEO pay briefing 2013 – Have new rules on top pay had any impact? June 2014 via http://highpaycentre.org/blog/government-reforms-fail-to-bring-executive-pay-back-to-reality

> There is no economic risk associated with measures to constrain executive pay. Evidence that CEOs would leave the UK if their pay were constrained is limited. Indeed, there is little evidence to accurately quantify just how much difference a Chief Executive makes.

> Inequality may also be damaging to the economy – it means more money is concentrated in the hands of the rich, who can afford to hoard it, as opposed to low and middle-income earners. Performance-related pay incentives that encourage executives to cut costs and investment in order to boost profits also harm the UK's productivity

> There is a strong business case for a different approach to executive pay. Perceived executive greed can be damaging to a company's reputation, while higher pay gaps between workers foster resentment and conflict within the workplace.

> Public opinion firmly supports measures to reduce income gaps. In polling for the High Pay Centre, 80% of people think that it should be a Government priority to reduce the gap between rich and poor. 80% also think that current pay gaps are unfair and do not reflect how hard people work.

As the Government's recent reforms are unlikely to address these problems, it is necessary to contemplate more radical measures.

Policies to deliver fairer, more proportionate executive pay

The following eight measures could represent the next stage of the project to deliver fairer, more proportionate pay for those at the top and confidence in the economic system from the wider public.

1 Representation for workers on company boards and remuneration committees, to bring a degree of 'real world' perspective to deliberations on executive pay

2 A legally binding corporate governance code with stakeholders including workers and consumers represented on regulatory bodies, to deter egregious executive pay packages and enforce proper sanctions against bad practice

3 A revised duty for company directors and investment professionals to act in the interests of all stakeholders – including employees, customers and wider society.

4 A qualifying period for shareholders' voting at company AGMs so that only those who are properly engaged with the company and interested in its long-term success are able to vote on executive pay, thereby ensuring that pay incentives reflect a long-term outlook.

5 A higher top-rate of income tax to discourage executives from demanding disproportionate pay increases.

6 Company-wide profit-sharing so that all employees benefit proportionally from a company's success.

7 A maximum pay ratio meaning that executives cannot earn more than a certain multiple of their lowest-paid employee.

8 A legally-binding commitment to reduce inequality focusing the attention of policymakers, other stakeholders and the general public on the need to tackle pay at the top.

Introduction: The top pay debate

The runaway growth of top pay for corporate executives has been a vexatious issue in public debate since the Thatcher era. The huge windfalls for executives of privatised utilities provoked outrage in the late 1980s and early 1990s. This led to the publication of the Cadbury report (1992) and the Greenbury report (1995). These major inquiries into corporate governance led to changes in the way that pay for the senior managers of publicly listed businesses was set. However, following the onset of the financial crisis in 2007, the continuing growth of executive pay, in contrast with falling wages and declining living standards across most of the UK population, again became a source of much public anger. As of summer 2014, pay for those at the top continues to prove contentious, with controversial pay packages for bankers and corporate executives featuring frequently in the media and the subject of concerns expressed by groups ranging from the Catholic Church to the World Economic Forum conference at Davos.[3]

Research from the High Pay Centre provides the statistical underpinning for the public concern. **Typical annual pay for a FTSE 100 CEO has risen from around £100-£200,000 in the early 1980s to just over £1 million at the turn of the 21st century to £4.3 million in 2012.**[4] This represented a leap from around 20 times the pay of the average UK worker in the 1980s to 60 times in 1998, to 160 times in 2012.

Following the public outcry over top pay, the Coalition Government introduced the new regulations in 2013, empowering shareholders with a binding veto over company executive pay policy and requiring companies to compare the percentage pay increase experienced by the CEO (not including so-called ‘Long-Term Incentive Plans, the single biggest component of executive pay) with that of the wider workforce (though a clause permits companies to choose a smaller ‘comparator group’ of employees – in some cases the comparator group has comprised less than 1% of the company workforce).

Analysis from the High Pay Centre suggests that these reforms have

[3] See International Business Times, Pope Francis Attacks High CEO Salaries In First Message Since Being Named Person Of The Year, 13 December 2013 via http://www.ibtimes.com/pope-francis-attacks-high-ceo-salaries-first-message-being-named-person-year-1506958 and BBC, Davos puts executive pay in the spotlight, 23 January 2014 via www.bbc.com/capital/story/20140122-the-big-payback

[4] High Pay Centre, One law for them: How big companies flout rules on executive pay, 2013, p4

[5] Office for National Statistics (ONS), Annual Survey of Hours and Earnings via http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/index.html and Average Earnings Index Historical Time Series via http://www.ons.gov.uk/ons/search/index.html?newquery=Average+earnings+index+historic+time+series&newoffset=50&pageSize=50&sortBy=none&sortDirection=none&applyFilters=true

[6] Based on the High Pay Commission’s analysis of six leading UK companies, High Pay Commission, Cheques with Balances, 2012 p23

table 1

Year	FTSE 100 CEO pay	FTSE 100 employee pay	Pay ratio (FTSE CEO: employee)	Average UK worker[5]	Pay ratio (FTSE 100 CEO:UK worker)
1980	£115,000[6]	n/a	n/a	£6,500	18:1
1998	£1,000,000	£21,500	47:1	£17,500	57:1
2012	£4,300,000	£33,967	127:1	£26,500	162:1

done little to bridge the pay gap between top executives and ordinary workers. Average CEO pay stood at £4.5 million for the 67 FTSE 100 companies to report pay in the three months following the introduction of the new regulations in September 2013.[7] Thus far, no FTSE 100 company has seen their pay policy voted down. Across all quoted companies in the UK, only one – the engineering company Kentz – has seen their pay policy voted down under the new regime.[8]

As such, it is likely that unless stronger measures to tackle runaway executive pay are introduced, the pay gap between those at the top and ordinary workers will remain or even widen.

Part 1: Why is it important to curtail runaway executive pay?

There are a number of reasons why a failure to address high executive pay would be socially and economically damaging:

Inequality

The growth in CEO pay has contributed to a wider increase in the gap between the rich and everybody else, both in absolute terms, and relative to other countries.

According to the World Top Incomes Database, **the richest one per cent of the UK population captured less than 6% of total incomes in the late 1970s, more than doubling to 13% in 2011** (the most recent year for which the database provides figures).[9] The Organisation for Economic Co-operation and Development (OECD) ranks the UK the 7th most unequal of the 32 advanced economies that are members of the OECD.[10]

Poverty

The fact that the UK has higher levels of inequality than other Western European economies with similar levels of average prosperity effectively means that while there are richer people here, there is also a lot more poverty.

Eurostat statistics show that **just 2 of the UK's 9 regions enjoy higher GDP per head than the EU average**.[11] OECD figures show that **the poorest fifth of the UK population have much lower incomes than the poorest fifth in other North-Western European economies,** while those of the top 20% are amongst the highest.[12]

This suggests that uneven distribution of incomes in the UK makes the poor worse off than they could be.

Precedent

Professor Thomas Piketty of the Paris School of Economics suggests that **pay for top executives or 'super managers' is a key driver of rising income inequality** in Europe and North America.

In the UK Professor Stephen Wilks notes that executive pay sets a benchmark for pay in other leading professions covering the financial services sector, corporate law firms and major accountants, professional services firms and consultancies.[13]

It is also common to hear senior public sector managers to compare their pay to what they could earn for similar levels of responsibility in a large private sector firm. Increases in executive pay have a wider effect, leading to a much bigger gap between a tiny well-paid elite and everybody else.

Social cohesion

The growing pay gap is also bad for social cohesion. Businesses, politicians and indeed the entire political and economic system cannot function without public consent. If the system is perceived to benefit only the richest and most powerful, then more extreme alternatives will become more appealing.

[7] High Pay Centre, FTSE 100 CEO pay briefing 2013 – Have new rules on top pay had any impact?, June 2014 via http://highpaycentre.org/blog/government-reforms-fail-to-bring-executive-pay-back-to-reality
[8] Guardian, Kentz shareholders first to vote down pay policy and remuneration report, 16 May 2014 via http://www.theguardian.com/business/2014/may/16/kentz-shareholders-first-vote-down-pay-policy-remuneration-report-revolt
[9] World Top Incomes Database, via http://topincomes.g-mond.parisschoolofeconomics.eu/#Database:
[10] Organisation for Economic Co-operation and Development, Factbook 2011-2012: Economic, Environmental and SocialStatistics via http://www.oecd-ilibrary.org/sites/factbook-2011-en/03/05/01/index.html?itemId=/content/chapter/fact
[11] Eurostat, GDP per capita in the EU in 2011: seven capital regions among the ten most prosperous, 27 February 2014 via http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/1-27022014-AP/EN/1-27022014-AP-EN.PDF
[12] OECD, Better Life Index via http://www.oecdbetterlifeind
[13] Stephen Wilks, The Political Power of the Business Corporation, 2013, p82

A number of leading figures from different political perspectives have already warned of the threat to political and economic stability posed by inequality.

Lloyd Blankfein, the CEO of Goldman Sachs, described income inequality as 'destabilising.'[14]

Tim Adams, President of the Institute of International Finance has said that failure to mitigate income gaps 'risks brewing more populist pressures on Governments.'[15]

Simon Walker of the Institute of Directors asked a High Pay Centre conference in 2013 *'What has done the most damage to the reputation of business and the free market in recent years? It hasn't been the G20 protests, or the Occupy tent cities. It has been the greed of those who demand and secure rewards for failure in far too many of our large corporations.'*[16]

Fairness

Anger at growing income gaps is likely to be supplemented by perceptions that levels of executive pay are dictated by vested interests and a narrow, unchallenged view of how company success is achieved, rather than performance or value for money.

The remuneration committees that set executive pay at top companies are dominated by serving or retired executives, who are likely to be instinctively sympathetic to other CEOs. In 2012, **46% of remuneration committee members were serving or former CEOs, while 90% had a background in business or financial services**.[17]

RemComs are also usually advised by remuneration consultants. These firms often provide a multitude of other professional services to the company. Therefore, they are dependent on the CEO on whose pay they pass judgement for business.

Similarly, the fund managers who control a large proportion shareholder votes on pay also benefit from a high pay culture, with pay packages in excess of over £10 million commonplace for leading executives in the asset management sector.[18] More than half of shares in UK companies are held by overseas investors.[19] Some estimates have suggested that the length of the average shareholding is now just 22 seconds as a result of computerised high frequency trading.[20] Therefore, **it is questionable whether shareholders and their representatives are sufficiently interested in the long-term effects of executive pay on the company or the wider economy to hold remuneration committees to account.**

If not, executives are able to get away with pay packages that are neither fair nor proportionate.

Lack of economic risk

Many of the arguments that seek to justify high executive pay have been widely debunked.

The risk of losing executive talent to better-paying foreign countries

[14] CBS News, Goldman Sachs CEO: Income inequality is "destabilizing, 10 June 2014 via http://www.cbsnews.com/news/goldman-sachs-ceo-lloyd-blankfein-income-inequality-is-destabilizing/
[15] Bloomberg, Davos Finds Inequality Its Business as Backlash Seen, 23 January 2014 via http://www.bloomberg.com/news/2014-01-23/davos-makes-inequality-its-business-as-political-backlash-seen.html
[16] High Pay Centre, Full text of Simon Walker's speech, High Pay Conference (15/04/13), via http://highpaycentre.org/blog/simon-walker-iod-the-rights-and-wrongs-of-high-executive-pay
[17] High Pay Centre, The New Closed Shop: Who's deciding on Pay? 2012 via http://highpaycentre.org/pubs/publication-the-new-closed-shop-whos-deciding-on-pay
[18] Financial Times, Asset management chief executive pay soars, 18 May 2014 via http://www.ft.com/cms/s/0/7b952016-cbd5-11e3-a93400144feabdc0.html?siteedition=uk#axzz329LE63T2
[19] ONS, Ownership of UK Quoted Shares 2012, via http://www.ons.gov.uk/ons/dcp171778_327674.pdf
[20] Daily Telegraph, How long does the average share holding last? Just 22 seconds, 18 January 2012 via http://www.telegraph.co.uk/finance/personalfinance/investing/9021946/How-long-does-the-average-share-holding-last-Just-22-seconds.html

has been exposed by research showing that **less than one per cent of the world's 500 biggest companies recruited a CEO from a foreign rival** – the international market for executive talent does not really exist.[21] In any case, it is questionable whether companies would suffer in the hypothetical event of losing executives to overseas rivals. **A number of academic works have cast doubt on whether or not 'superstar' CEOs make much difference to a company's success.**[22]

Most major UK companies have histories extending back for many years – their Chief Executives are managers appointed to the role, rather than entrepreneurs who have built the company from scratch. **Existing brand power and company infrastructure, plus the wider economic context, make much more difference to companies than one or two top executives** who cannot possibly hope to take full responsibility for day-to-day operations involving thousands of employees and customers in dozens of companies.

The highly-paid executives are not as vital as they or their advocates think.

Social problems

'The Spirit Level' by Professors Richard Wilkinson and Kate Pickett found that in advanced economies, **higher levels of inequality correspond with heightened health and social problems.** The UK generally suffers higher instances of obesity, teenage pregnancy, drug use and violence, but lower levels of trust and social mobility, compared to more equal societies like France, Germany, Finland, Sweden and the Netherlands.[23]

The economic case

A number of economists have also argued that **inequality is also bad for economic growth.** Raghuram Rajan claims that the increasing levels of debt taken on by low and middle-income households was a response to rising inequality and their difficulty keeping pace with the living standards of the rich. The failure of many of these households to maintain repayments was at the root cause of the financial crisis.[24]

Stewart Lansley observes that a sustainable economic recovery could be hindered by the fact that so much money is concentrated in the hands of a wealthy elite - who can afford to invest it in property or financial assets - rather than low and middle-income households, who spend it in the productive economy.[25]

On executive pay specifically, Economist Andrew Smithers has argued that **the UK's recovery from the 2008-09 financial crisis cannot be sustained without reform of the incentive payments that form the largest component of executive pay packages.**

Smithers' argument is based on the fact that incentives are usually linked to company share price

[21] High Pay Centre, Global CEO Appointments: A very domestic issue, 2013 via http://highpaycentre.org/pubs/the-myth-of-global-high-pay-talent-market
[22] See for example Professor Philip Rosenweigh 'The Halo Effect' or Professor Rajesh Khurana, Searching for a Corporate Savior: the irrational quest for Charismatic CEOsl
[23] Richard Wilkinson and Kate Pickett, Richard Wilkinson and Kate Pickett, The Spirit Level: Why equality is better for everyone, 2009, p52-161
[24] Raghuram Rajan, How inequality fuelled the crisis, 2013 via http://www.project-syndicate.org/commentary/how-inequality-fueled-the-crisis
[25] Stewart Lansley, The Cost of Inequality, 2011

or profitability over a short-term time period (typically three years). As such, business leaders are incentivised to take measures that cut costs and boost profitability or share price in the short-term – for example, by laying off staff, extending the life-cycle of dated equipment or buying back company shares. It is not in their personal interest for the company to undertake activities that benefit the wider economy in the long-term – such as committing money to staff training and development or investing in research and technology to bolster productivity.[26]

The business case

There is an obvious reputational risk to organisations that are perceived to be making obscene and disproportionate payments to top executives, or who have a particularly egregious pay gap between their executives and ordinary workers. UK banks, in particular, have suffered severe reputational damage that constitutes a strategic threat to their businesses.

However, huge pay gaps can also do more direct damage to businesses – academic research shows that 'distributive justice' is an important factor in determining employees' attachment to their employer. Many studies have found that **organisations with more equal levels of pay perform better, because workers are less resentful of senior managers and the company and more willing to go the extra mile for their employers.**[27]

Research for the High Pay Centre by academics at Queen Mary, University London, found that absenteeism, staff turnover and industrial disputes were all higher in workplaces with higher pay differences between staff.[28]

Opportunity

Equality of outcome remains a politically contentious issue, but the need for greater equality of opportunity is universally agreed.

Research shows that income **differences between children growing up in the seventies and eighties were more likely to be reflected in adulthood than for those growing up in the fifties and sixties.**[29]

While education and training is heralded as the solution to both equality of opportunity and equality of outcome, separate studies also prove that, even when factors such as quality of schools or parenting are taken into account, **household incomes make a huge difference to children's educational outcome.**[30]

We cannot have equality of opportunity unless incomes are distributed more evenly and the gap between those at the top and everybody else are dramatically reduced.

Public opinion

There is strong support for measures to reduce the income gap between pay at the top and everybody else. The High Pay

[26] Andrew Smithers, The Road to Recovery: How and why economic policy must change, 2013
[27] See for example: Douglas Cowherd & David Levine, Product quality and pay equity between lower-level employees and top management: an investigation of distributive justice theory in Administrative Science Quarterly, Vol 37 No.2, 1992, p316; Matt Bloom, The Performance effects of Pay Dispersion on Individuals and Organization in Academy of Management Journal, Vol 42 No. 1, 1999, p38; Pedro Martins, Dispersion in Wage Premiums and Firm Performance in Working Paper, Centre for Globalisation Research, Volume 8, 2008 via http://webspace.qmul.ac.uk/pmartins/CGRWP8.pdf; and Olubunmi Faleye, Ebru Reis and Anand Venkateswaran, The Effect of Executive-Employee Pay Disparity on Labor Productivity, 2010, p5
[28] High Pay Centre, The High Cost of High Pay: An analysis of pay inequality within firms, 2013 via http://highpaycentre.org/pubs/the-high-cost-of-high-pay-unequal-workplaces-suffer-more-strikes-and-higher
[29] Institute of Education, Education and Intergenerational Mobility: Help or Hindrance? 2014 via http://repec.ioe.ac.uk/REPEc/pdf/qsswp1401.pdf
[30] Joseph Rowntree Foundation, Does money affect children's outcomes? 2013 via http://www.jrf.org.uk/publications/does-money-affect-childrens-outcomes

Centre conducted polling in partnership with ICM examining attitudes towards top pay and inequality. The polling found that **80% of people agree that it is important for Government to reduce the gap between rich and poor.**[31] A solid majority of voters for each party also agreed with this statement, including 73% of Conservative voters and 80% of UKIP supporters.[32]

For all voters, more people agreed that reducing the gap between the rich and poor should be a priority for Government than a number of other policy issues including:

> Reducing immigration (77%)

> Building more homes (72%)

> Cutting taxes (71%)

> Reducing the amount spent on benefits (68%)

> Changing relations with the European Union (68%)[33]

When asked if the pay gaps between high and low/middle earners are unfair, 80% of respondents agreed or strongly agreed. The same proportion agreed that pay gaps in the UK are too large, and make it hard for people on the bottom to get by. When the question was posed from a different perspectives, asking if the pay gaps that exist in the UK were necessary to encourage people to work hard and take risks, just 33% of people agreed, while 55% disagreed.

Taken together, these arguments create a clear and forceful case for radical action to substantially reverse the relative pay growth enjoyed by top executives at the expense of ordinary workers over recent decades.

[31] High Pay Centre, UKIP Supporters say tackling rich/poor gap is higher priority than taxes and benefits, 2014, via http://high-paycentre.org/blog/ukip-supporters-say-tackling-rich-poor-gap-is-higher-priority-than-taxes-an
[32] ibid
[33] ibid

Part 2: Policies to deliver fairer, more proportionate executive pay

We have identified eight initial policies that could potentially address excessive executive pay and deliver a fairer, more proportionate, economically sensible distribution of incomes across the UK. Some of these policies could be addressed within a single new Companies Act, outlining the role and responsibilities of companies and their Directors, their expected code of conduct and their corporate governance structures. Others would require further, more specific actions from Government.

It is not necessarily the position of the High Pay Centre to endorse these policies – in some cases we have simply outlined policies proposed by expert organisations or individuals, or those proposed or implemented in other countries.

However, the top pay problem is now a critical policy issue in the UK. Despite the overwhelming argument and public appetite for a change to executive pay culture, reforms to date have achieved very little.

Therefore, the time has come for more forceful measures to be seriously debated.

Policy 1: Worker representation on company boards and remuneration committees

How would this work?

A new Companies Act would require all UK businesses over a certain size to offer elected representatives of their workforce a non-executive position on their board. These representatives would also sit on the company remuneration committee.

As non-executive Directors, workers' representatives would be paid – a small fee levied on these payments could help to fund a training institute for employee directors similar to the Hans Boeckler Stiftung, which serves a similar purpose in Germany.

To be truly effective in delivering worker participation in and influence over the pay setting process (and other strategic decisions), worker representation at board level would need to be combined with measures to improve employee engagement throughout companies – for example, in individual teams and workplaces. This could involve the expansion of works councils and promotion of the right to request formal consultation on companies' strategic decision-making.

Why would it make a difference?

Polling for the High Pay Centre suggests that worker representation on company boards is supported by 65% of the electorate.

Worker participation on remuneration committees would bring some 'real world perspective' to deliberations on executive pay.

It would be much more difficult for other non-executive directors to tell a company employee – who would also have contributed to the company's success - face-to-face that they felt that the CEO merited a pay package close to 200 times the average UK worker. Worker representation on boards and remcoms would also enable a channel of communication between senior management and the workforce that would reduce the likelihood of executive pay becoming a source of resentment and conflict across the wider workforce.

Countering the counter-arguments:

The UK is ranked 26th out of 27 EU for worker participation in company decision-making, ahead only of Lithuania.[34]

Structures enabling worker input into strategic decisions, including representation on boards and remuneration committees, are an established part of day-today business for companies in Germany or Sweden, for example.

These countries rank higher than the UK on the global competitiveness index and are home to numerous thriving businesses.[35] Workers on boards are not a threat to UK businesses, but an opportunity to work more effectively.

One of the arguments put forward against the election of employees onto company boards is that they will not understand the proceedings. However, with appropriate training and back-up as is available to most new non-executives, there is no reason to suppose that workers would not make a meaningful contribution. In fact, they will often know the company business better than outsiders and can flag up issues that might not have been noticed by the board before.

When the High Pay Centre spoke to German business leaders as part of a study into German corporate governance, they felt that the German system was preferable to the adversarial model of British industrial relations – the communication channel meant that company policy could be clearly conveyed to the workforce, while ideas and perspective from 'the shop floor' were fed into senior management.[36]

Representation on boards meant that trade unions were required to compromise with management and take responsibility for corporate decisions, rather than take a more oppositional approach.

[34] European Trade Union Institute, European Participation Index, 2010 via http://www.worker-participation.eu/About-WP/European-Participation-Index-EPI
[35] World Economic Forum, The Global Competitiveness Report 2013 – 2014 via http://www3.weforum.org/docs/GCR2013-14/GCR_Rankings_2013-14.pdf
[36] High Pay Centre, Workers on Boards: Interviews with German Employee Directors, 2013 via http://highpaycentre.org/pubs/workers-on-boards-interviews-with-German-employee-directors

Policy 2: Make a new Corporate Governance Code legally-binding, with all stakeholders – including workers and consumers – represented on the regulatory bodies monitoring compliance.

How would this work?

The UK Corporate Governance Code currently works on a 'comply or explain' basis, meaning that though non-compliance is monitored and can result in adverse publicity, it is not illegal.

Under this proposal, the Code would be enshrined in a new, legally-binding 'Companies Act' also ensuring that monitoring bodies such as the Financial Reporting Council included representation from company employees, consumer groups and wider society. Trade unions, consumer groups and civil society organisations could nominate candidates for these roles, but it would be important to open the process to members of the public. The current wording of the code, requiring companies only to 'show sensitivity' to pay and conditions elsewhere in the group when setting executive pay would be replaced with a more meaningful requirement to publish CEO pay as a multiple of the company's lowest paid-worker.

Why would it make a difference?

The aspects of the Corporate Governance Code relating to the pay gap between executives and ordinary workers are largely ignored at present.

High Pay Centre analysis found that many companies respond to the requirement to 'show sensitivity to pay and conditions elsewhere in the group' with 'boilerplate' statements in annual reports that simply say they have shown sensitivity or taken workers' pay into consideration, without showing how this had any tangible impact on the executive's pay package.[37]

If the code contained clearer directions, backed up by the threat of legal action and enforced by consumers and workers more likely to challenge the pay culture than the government and city figures who currently dominate regulatory bodies, companies would begin to take their responsibility to deliver fairer, more proportionate pay packages more seriously.

Countering the counter arguments:

Proponents of the Corporate Governance Code in its form argue that it offers clear guidelines while the 'comply or explain' principle still allows for some flexibility.

However, corporate citizenship in the UK has been less than exemplary. Even business leaders are now concerned by the public perception that big business is a law unto itself.

A legally-binding Corporate Governance Code would provide a significant deterrent to malpractice on pay and other areas, while also providing a mechanism via which justice could be seen to be done when wrongdoing did occur.

[37] High Pay Centre, One Law for them: How big companies flout rules on executive pay, 2013 via http://highpaycentre.org/pubs/one-law-for-them-how-big-companies-flout-rules-on-executive-pay

The key objection to representation for consumers and workers on regulatory bodies is that they lack the necessary expertise. However, this is more than offset by the challenge and enthusiasm that a fresh perspective would bring to trust, ethics and reputational issues.

When the High Pay Centre presented evidence in April 2014 of several breaches of laws and regulations on executive pay we were unable to find a regulatory body claiming responsibility for monitoring and enforcing compliance with the relevant laws and regulations.[38] After the Financial Reporting and Review Panel promised to investigate, we have not, as of June 2014 received a reply, despite being promised one by the end of April.

Regulators and Companies alike have grown complacent with regard to their reputation as a cosy and self-enriching cartel. The need for a radical new approach outweighs insider concerns about the threat to established process and convention.

Policy 3: A wider legal responsibility for both Company Directors and Investment Intermediaries to act in the interest of all stakeholders in a company, not just shareholders

How would this work?

The 2006 Companies Act requires Company Directors to act in a way 'most likely to promote the success of the company for its members as a whole' while also having regard for factors such as the interests of employees or the surrounding community.

Our proposal would involve a new Companies Act, requiring Directors to have equal regard for the interests of all stakeholders – including employees, customers, partners and suppliers and wider society, as well as shareholders, in their strategic decision-making process. This would be complemented by a corresponding, legally-binding Financial Services Code of Conduct, requiring all investment intermediaries to have regard for all stakeholder communities when undertaking any investment activity, including the exercise of voting rights on company pay policies.

Why would it make a difference?

The current Companies Act mandates company directors to have regard for wider social and environmental considerations when exercising their responsibilities, but ultimately, it requires them to maximise profits for shareholders.

[38] High Pay Centre, High Pay Centre and Partner Organisations write to the Financial Reporting Council, 17 March 2014 via http://highpaycentre.org/blog/high-pay-centre-and-partner-organisations-write-to-financial-reporting-coun

This does not necessarily work in the interest of wider society or the UK economy as a whole. Short-term or overseas-based shareholders may be indifferent to the effects of socially divisive pay policies, whereas workers, customers and the general public are deeply affected. If Directors and investment intermediaries were legally required to consider the interests of these stakeholders as equal to those of shareholders when awarding and approving executive pay packages, executive pay could reduce to more sensible levels with a closer relationship to the pay of the wider workforce.

Countering the counter-arguments:

Any attempt to promote stakeholder value is usually greeted with the response that shareholders are the legal owners of the company and that measures to dilute their influence are an infringement of property rights. But their legal and moral claim to primacy over other stakeholders is dubious. Legal opinion is divided as to what rights a 'shareholding' specifically entails, and whether it constitutes, for example, a share of ownership of the company, or the company's assets or merely a claim on a share of company profits.

Morally, it is entirely possible to see a shareholder as simply someone who has bet on the profitability of a company – similar to a creditor or a debenture-owner – and that this does not entitle them to take precedence over other stakeholders.

Employees, for example, rely on a company to provide their livelihood in a way that shareholders, with a diverse portfolio of investments, do not. Customers may rely on a particular company's product to support or sustain their lifestyle. The wider community may be negatively affected by a company's environmental impact or their socially divisive pay policies, even if these benefit shareholders in the short-term.

So it is certainly possible to see how shareholder primacy, as enshrined in existing law, could be bad for the UK as a whole.

Policy 4: A qualifying period for shareholder voting rights

How would this work?

The new Companies Act would require shareholders to maintain their shareholding for a minimum period of time before being granted voting rights at company AGMs (including over executive pay policy).

Why would it make a difference?

As shares are traded with increasing frequency thanks to computerisation, a huge number of shareholders are not particularly engaged with the companies in which they hold shares. As we have noted, shareholders, particularly those based overseas, are unlikely to be particularly engaged in company pay policy or its long-term effects if they intend to sell their shares in the immediate future.

This could make it harder for shareholders opposing pay policy to win a binding vote, if less-engaged shareholders are voting pay policy through uncritically. If only those with a long-standing commitment to the company were permitted to vote, this would encourage the company to take a longer-term focus on pay and on more general strategy. Weighted voting rights in favour of long-term shareholders are already a key part of corporate governance in countries such as Sweden and France, while many Silicon Valley firms – including Facebook, LinkedIn and GroupOn – floated with dual class shares giving their founders, who were thought to be more invested in the long-term success of the company, much stronger voting rights.

Countering the counter-arguments:

Again, this measure would be likely to prompt debates around property rights, based on the contestable notion that shareholders are the ultimate owners of the company and should be the final beneficiaries of its success (or bear the cost of its failure). Therefore, they are affected by a company's strategic decisions, regardless of how long they have held their shareholding and as such, have a right to a say, regardless of how long they have held their stake.

But if we see shareholders as simply betting on the fortunes of a company, rather than being its actual owner, this argument weakens. Moreover, the practical argument of empowering long-term shareholders whose interests correspond with the wider economy (ie companies that thrive in the long-term), over short-term speculators negates more abstract concerns about whether a shareholding ought to entail particular property rights.

Policy 5: A higher top rate of income tax

How would this work?

A return to the 50p rate of income tax for those earning over £150,000. This could be supplemented by a super-tax, based on the French model of a 75% levy on those earning over €1 million

Why would it make a difference?

Researchers have argued that the rapid increase in executive pay from the early 1980s onwards coincides with a decline in the top rate of tax. Thomas Piketty argues that this was because as top rates of tax dropped, it was more advantageous for those with economic power to demand higher pay packages, because they didn't lose such a large proportion of the gains in tax.

A higher top rate of tax would thus remove much of the incentive for executives to demand obscene pay packages, resulting in a fairer, more socially cohesive society. 68% of the electorate, according to our polling, support proposals to raise the top rate of tax to 50% on earnings over £150,000.

Countering the counter-arguments:

This should not be viewed as an anti-aspirational measure. Even if one assumes that executives are motivated solely by the absolute sums of money they receive – as opposed to responsibility, status, recognition and reward relative to others – reducing the standard executive pay package from around £4 or £5 million to £1 million, or even £150,000, would afford them a lifestyle far beyond the imagination of the vast majority of the population.

The argument that top talent would flee overseas is, as we have shown in Part 1, based on two contentions. Firstly, that the super-rich would leave and would be able to find alternative employment in the event of higher taxation in the UK. Secondly, that other talented managers, willing and able to do the job successfully for reduced sums of money, would be impossible to find. There is little evidence to support either assumption.

It would of course be possible to pre-empt both arguments altogether by negotiating an international agreement –perhaps initially at European level – to ensure that a minimum level of tax were applied to top earners internationally, mitigating division and inequality across all economies.

Policy 6: Company-wide profit-sharing to replace executive bonus schemes

How would this work?

Companies over a certain size would be compelled to offer a certain proportion of company profits to their employees. This could be a simple mechanism whereby companies are required to distribute a proportion of profits equally to all employees. In France, profit-shares are compulsory for all companies with over 50 employees that increase dividend payments above the average of the previous two years.

Why would it make a difference? One of the most egregious aspects of existing executive pay practices is that they reward a tiny number of top managers with million-pound pay and bonus packages, as a result of successes achieved by thousands of employees worldwide.

If bonus and incentive schemes were capped at a fixed proportion of salary or company profits, and applied on the same basis to all employees, this would directly limit the size of executive pay packages and prevent executive pay growth from outpacing that of ordinary workers.

Even if not tied to executive pay, however, the symbolic effect of profit sharing could indirectly lead to fairer, more proportionate executive pay packages.

In recognising that all company employees contribute to a company's success and therefore should share in it, profit-sharing would represent a powerful challenge to the notion of CEOs as god-like wealth creators bestowing prosperity on the rest of us. The propagation of this myth – for example, the frequent use of terms such as 'top talent' and 'wealth creators' in the media – currently enables executives to capture such disproportionate pay packages.

High Pay Centre polling also indicates that 81% of the public support a requirement on companies to share profits with all employees.

Countering the counter-arguments:

This proposal is likely to be seen as an imposition on businesses, resulting in increased costs and restrictions on their capacity to take decisions as they see fit.

However, the success and sustainability of our economic system depends on the understanding that everyone benefits fairly from their work. Though executives may have ultimate responsibility for the strategic decisions taken by a company, this is often the result of advice passed through the company hierarchy by more junior employees. The execution of these decisions is, of course, dependent on all employees, not just the executives. Furthermore, company success is also dependent on much wider factors, particularly the economic context.

That executives are well-positioned to capture the rewards of other people's efforts – often at the expense of ordinary workers, as borne out by widening inequality – is a greater concern than philosophical objections to Government intervention. Mandatory profit-sharing would only affect executive pay, rather than wider company strategy, and it is already applied voluntarily by some of the UK's more enlightened (and successful) companies.

TSB which floated as a separate bank in June 2014, marked itself out as introducing an ethical pay policy when it extended profit-share to the entire company on a percentage of salary basis. It did, however, retain a separate executive bonus scheme.

Government has a democratic mandate – a responsibility even – to put structures in place that can deliver fair outcomes. Compulsory profit-sharing could be one such mechanism.

Policy 7: A maximum pay ratio, limiting the pay of company CEOs to a fixed multiple of their average employee

How would this work?

A clause in a new, legally-binding Corporate Governance Code, limiting the total amount paid to the Chief Executive to a multiple of the average employee.

The precise multiple would be subject to discussion and expert analysis – but as a guideline, a referendum in Switzerland voted against a proposal to cap executive executive pay at 12 times that of their lowest-paid employee. The management expert Peter Drucker suggested in the 1970s that the maximum ratio should be no higher than 20:1. The John Lewis Partnership in the UK caps pay for its Chairman at 75 times that of the average employee.

There also needs to be consideration of a variation in ratios for different sectors of business. A supermarket or mining company that employs a large number of low-paid staff, will have a much higher ratio than an investment bank or asset management company, for example.

Why would it make a difference?

Fixing CEO pay to pay for ordinary workers would send an important message about proportionality and the role that every individual plays in contribution to an organisation's success.

It would limit the amount the CEO could receive without awarding a corresponding increase to the workforce, thereby reducing much of the public and employee resentment.

This measure would undoubtedly be strong, but if the objective of executive pay policy were to remove public resentment and restore faith in business and the UK's socio-economic system more generally, it would have a very strong chance of succeeding. The principle of capping CEO pay at a multiple of the company's lowest-paid employee has the support of 78% of the public, according to our polling.

Countering the counter-arguments:

The principle of Government setting rules determining what a company can and cannot pay might seem objectionable to some fundamentalist libertarians.

But companies are already subject to dozens of regulations – on areas ranging from immigration to the minimum wage to the environment – to prevent them from acting in ways that maybe detrimental to the interests of wider society. Rules on socially divisive pay policies would be consistent with this approach and would enjoy public support.

Furthermore, is the principle of Government moderation of company pay policies more of an affront to freedom and democracy than the current practice of those with the most economic power (executives, remuneration committee members and fund managers, for example) exploiting their position to ensure a distribution of incomes across the UK that enables them to capture an unfair and disproportionate share of total pay?

This is not only more of an injustice than a maximum pay ratio, it also threatens public support for businesses and executives – a pay ratio would save them from the consequences of their own excesses.

Policy 8: A legal limit to social inequality in the UK

How would this work?

The Government could introduce a bill setting a legally-binding target to reduce inequality in the UK to a certain level, based on similar measures used to tackle child poverty and carbon emissions.

This could be measured using the Gini co-efficient, or an indicator more understandable to the layperson, such as the share of total income going to the richest 1 per cent.

Alternatively, it could initially be adopted as a more informal goal, based on the Bank of England's inflation target or the recent commitment by the Chancellor of the Exchequer to make UK employment the highest in the G7. Taking either approach, the commitment could deal solely with income inequality of encompass separate measures for both income and wealth inequality.

Why would it make a difference?

Firstly, it would create a legally-binding obligation on Governments to take action to reduce the gap between the super-rich and everybody else, thereby creating impetus for radical reform in relation to executive pay.

The very existence of such a target would increase the prominence of inequality as a matter of public concern. Progress towards the target would be a subject of frequent media scrutiny and debate. Again, this would create pressure for policy action, but it would also represent a statement about the kind of fair country that we want the UK to be. This would increase social pressure on companies to reward their senior managers in a fairer, more proportionate way.

Polling asking the public whether a legally-binding commitment to reduce the share of total income going to the top 1% shows that 70% of the public support this proposal.

Countering the counter arguments:

The fact that many such targets already exist in various forms, supported by politicians of all parties, is a powerful rebuttal to the argument that this would constitute intolerable interference in the economy.

We should also ask whether a real situation where those at the top are paid millions for stewardship of an already successful company while those at the bottom struggle to feed their families and heat their homes, despite having paid jobs, is more desirable than this rather abstract fear of intervention in the market. Our attachment to the so-called 'free' market should be pragmatic, rather than dogmatic. Such shocking differences in pay are clearly undesirable. It is absurd to tolerate them, whether or not they result from the 'free' market. In any case, the cosy relationships between those involved in setting executive pay and the practical difficulties for other stakeholders in holding them to account suggest that the market for executives is seriously dysfunctional.

A somewhat contradictory objection to this proposal concerns Government's ability to actually meet targets of this kind. This is a more powerful argument, but as already stated, the very existence of such a target would create pressure for action – from Government, but also from business, local Government and the voluntary sector – thereby making reduced inequality and fairer pay at top and bottom a more likely outcome.

Conclusion

Wholesale adoption of this manifesto may not be appropriate for any UK political party or Government.

However, there are economic, social and moral reasons why current levels of top pay and inequality are a problem. Current policies and structures will not address them in a meaningful way.

The biggest obstacles to adoption of these policies are vested interests, political feasibility and flawed business policy conventions. If we are to build a strong, sustainable economy in which people are fairly rewarded for their contribution, policymakers will need to be braver in discussing the ideas and arguments proposed in this paper.

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