ONE LAW FOR THEM

HOW BIG COMPANIES FLOUT RULES ON EXECUTIVE PAY

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.

Thanks to Nadia Erlam and Ashley Kemball-Cook for help with the research for this paper, and to Janet Williamson of the Trade Unions Congress for comments on earlier drafts

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Executive Summary

In recent years, policymakers, commentators and the general public have become increasingly concerned at the widening pay gap between a small number of top earners and the rest of the population.

The contrast between company executives, whose multi-million pound pay packages have multiplied over the past decade, and ordinary workers, whose wages have stagnated, is particularly worrying. A growing body of academic research has documented the debilitating effects of inequality. It is questionable whether an economy in which a tiny super-rich elite accrue such a disproportionate share of total incomes can sustain itself in the long-term.

The UK Corporate Governance Code requires companies to show sensitivity to pay and conditions of their workers when setting executive pay. The 2008 Large and Medium Sized Companies Regulations also state that companies should show ***how*** this was done. In Autumn 2013 amendments to the regulations were published. These new measures specifically require companies to compare the increase in salary and bonus for their executives with that of their average employee. They also state that companies should show how they consulted with employees.

Our analysis shows that FTSE 100 companies do not currently comply with the Corporate Governance Code or the Large and Medium Sized Companies Regulations. **No FTSE 100 company publishes a pay ratio between their executive and the lowest or median pay of their employees.** This would be the clearest way of relating executive pay to that of the rest of the workforce. It would allow meaningful analysis of whether or not the company had displayed sensitivity to the workforce when setting executive pay.

Instead, responses to the various regulations on the relationship between executive and worker pay fall into two categories

1/ Saying not showing – the vast majority of FTSE 100 companies – 84 in total – say in their Director's Remuneration Report that they have shown sensitivity to pay and conditions in the rest of the

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

Year	FTSE 100 CEO pay	FTSE 100 employee pay	Pay ratio (FTSE CEO: employee)	Average UK worker	Pay ratio (FTSE 100 CEO:UK worker)
1980	£115,000	n/a	n/a	£6,500	18:1
1998	£1,000,000[1]	£21,500	47:1	£17,400	57:1
2012	£4,500,000	£33,967	133:1	£26,500	170:1

workforce but do not provide evidence of how they have done so, or the effect that it had on pay.

These companies statements generally take the form of unsubstantiated pronouncements such as the following:

'Pay and employment conditions across the group are taken into account when setting the remuneration of executives.'
- Centrica

or

'The Committee receives regular updates on salary increases, bonus and share awards made to employees throughout the Group. These matters are considered when conducting the annual review of executive remuneration'
- Babcock International

2/ Not the whole story – 16 FTSE 100 companies do compare salary increases of Directors to those of the wider workforce and provide concrete figures comparing salary increases for executives and ordinary employees. But in each case, these figures refer to base salary only.

As base salary only accounts for a fraction of executive pay, these companies also fail to properly demonstrate the full contrast between executive pay and pay and conditions of the workforce. They also only detail the change in pay for executives and workers, rather than the difference in total pay.

Examples include:

The average increase for established Executive Directors last year was 2.4%. The average increase for senior management below Board level last year was 2.4%, and for other employees the average increase was typically around 2.5%.'
- Tesco

and

'The percentage salary increases awarded to the Executive Directors were below the average percentage base salary increases awarded across the Group.'
- BG Group

It is unlikely that the new Autumn 2013 regulations will improve the situation. Compliance with the requirement to consult with employees across the company is likely to take the form of vague claims to have sought updates on pay made to employees across the company. Some companies already include similar statements in their remuneration report.

The new regulations do not require companies to disclose a total pay ratio between executives and workers. They also allow companies to ignore long-term incentive plans (LTIPs), the largest single component of executive pay, when comparing pay increases for executives and workers.

As such, we recommend that the corporate governance code be amended to require companies to relate pay for their wider workforce to the total pay of their lead executive, not just their base salary and annual bonus.

This would provide clear guidance on executive pay. It would prevent companies from complying with the letter of the code, by raising base executive salaries in proportion to workers wages, but flouting its spirit by awarding massive bonuses to top management.

We also recommend that Government should require listed companies to disclose the pay ratio between their highest and lowest paid employee.

Given that the 2013 changes to the Large and Medium Sized Companies Regulations already mandate companies to report on relative pay increases, asking them to provide a total pay ratio would not constitute an additional reporting burden.

Corporations are likely to resist these measures, but it is not in their long-term interest to do so. An economic mode that enables the unchecked growth of such a huge gap between the super-rich and everyone else is unlikely to sustain popular legitimacy.

In this light, measures to address the growing income disparities within UK companies should be seen as pro-business, while the corporate power arrayed against the kind of reforms we outline may eventually prove the biggest threat to market economics.

The runaway growth of executive pay

A significant increase in pay for leading company executives in the UK has taken place since the late 1970s.

Pay packages for the average FTSE 100 CEO have quadrupled in the past 10 years, frovm an average just over £1 million awarded in 2002 to an average of £4.5 million in 2012.[2] Data extending back further is difficult to access but analysis by the High Pay Commission, studying pay at six leading companies since 1979, found that executive pay packages that year ranged from £75,000 to £225,000.[3]

At the same time, pay for low and middle income earners has stagnated. Analysis for the Resolution Foundation suggests that median wages in the UK remained flat between 2003 and 2013.[4] Leading economist Gavyn Davies has argued that low wage growth accounts for more than two thirds of corporate profits since the 1980s.[5] As a substantial proportion of these profits have been used to pay dividends to shareholders, executives (who are directly paid in restricted shares) have directly increased their pay at the expense of their workers.

In 2012, average pay for a FTSE 100 CEO was about 170 times the average UK worker.[6] In 1998, they were paid 47 times as much.[7] The more limited data from the late 1970s suggests that the ratio of pay between a big company boss and the average UK worker was generally around 10 or 20 to 1.[8]

Rising inequality

Executive pay sets a high-profile benchmark for top pay in other industries across the economy – Professor Stephen Wilks, for example, notes that the big financial services firms working with major corporations have experienced similar increases in top pay. Profit per partner at the big four accountants in the UK ranged from £633,000 - £770,000 in 2010.[10] For the magic circle law firms, the figure ranged from £1.6 million - £2.6 million.[11] It is also commonplace to see comparisons with private sector executive pay cited in defence of

[2] Manifest/MM&K, Manifest/MM&K Executive Director Total Remuneration Survey 2013, p41
[3] High Pay Commission, Cheques with Balances: why tackling high pay is in the national interest, 2011, p23
[4] Resolution Foundation, Historic Wage Freeze has now lasted four years, 13 November 2013 via http://www.resolutionfoundation.org/press/wagesriseslowert-hanprices48thmonth/
[5] Financial Times, The real underpinning for equities, 11 June 2013 via http://blogs.ft.com/gavyn-davies/2013/06/11/the-real-underpinning-for-equities/
[6] Executive Director Total Remuneration Survey, p41 and Office of National Statistics, Annual Survey of Hours and Earnings, 22 November 2012 via http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/index.html
[7] Ibid
[8] Cheques with Balances, p23
[9] Based on the High Pay Commission's analysis of six leading UK companies, Cheques with Balances, p23
[10] Ibid
[11] Ibid, p82

table 1 **The growing pay gap**

Year	FTSE 100 CEO pay	FTSE 100 employee pay	Pay ratio (FTSE CEO: employee)	Average UK worker	Pay ratio (FTSE 100 CEO:UK worker)
1980	£115,000	n/a	n/a	£6,500	18:1
1998	£1,000,000[9]	£21,500	47:1	£17,400	57:1
2012	£4,500,000	£33,967	133:1	£26,500	170:1

Data from Manifest/MM&K Executive Director Total Remuneration Survey 2012 (p78) and 2013 (p41) increasing pay packages for senior public sector managers.

The net effect has been to increase the share of the income accruing to the richest one per cent from 6 per cent in 1979 to 12 per cent in 1998 and 14 per cent in 2009 (the latest year for which figures are available)[12]

The economic and social case for fairer pay distribution

Many economists have highlighted the danger that this development poses to the economy. Stewart Lansley, for example, argues that the increasing share of income captured by the rich reduces consumption – richer households can afford to hoard a higher proportion of their income, whereas low and middle earners tend to spend any increase in the productive economy.[13] Raghuram Rajan cites the widening pay gap between high and low/middle income households as a key cause of the 2007 financial crisis. As ordinary workers incomes stagnated and the pay of top earners raced away, those on low and middle incomes took on an increased debt burden in the effort to keep up.[14]

Academics Richard Wilkinson and Kate Pickett document the close relationship between inequality and multiple health and social problems. In the developed world, levels of obesity, teenage pregnancy, drug use and violence are higher and levels of trust and social mobility lower in more unequal societies, such as the UK and USA, compared to countries like Germany, Holland, Japan and the Nordic countries where wealth is distributed more equally.[15] Therefore, if executive pay growth in the UK continues to outpace wage increases for ordinary workers, we can expect these problems to worsen.

At firm level, a number of academic studies have shown that high differences in pay between high and low earners within a company can have a detrimental effect on performance. Lansley cites a series of academic studies that show companies with a more equal pay distribution perform better than counterparts with less equal pay. This is supported by research for the High Pay Commission, showing that employees tend to compare their own pay both to peers and those above them in the company hierarchy and that a higher pay gap weakens employee engagement.[17]

This in turn can result in higher staff turnover/absenteeism and lower commitment. So if top executives' pay increases outpace those of ordinary workers it is likely that productivity and customer service will suffer while accidents, industrial disputes, and recruitment, training and administration costs will increase.

Regulatory requirements on the pay gap

Government and regulatory authorities acknowledge the risks posed by excessive executive pay and a widening income gap between top earners and the rest of society. But there remains concern that existing structures are not strong enough to prevent growing

[12] All figures via the World Top Incomes Database, http://topincomes.g-mond.parisschoolofeconomics.eu/#Database:
[13] Stewart Lansley, The Cost of Inequality: Why economic equality is essential for recovery, 2011
[14] Raghuram Rajan, How inequality fuelled the crisis, 9 July 2010 via http://www.project-syndicate.org/commentary/how-inequality-fueled-the-crisis
[15] Richard Wilkinson and Kate Pickett, The Spirit Level: Why equality is better for everyone, 2009, p52-161
[16] Stewart Lansley, Inequality and Instability: Why more equal societies have more stable economies in One Society, The Coalition Government and Income Inequality: half term report, 2012, p10
[17] Cheques with Balances, p26-28

pay ratios from damaging the UK economy.

The UK Corporate Governance Code outlines principles and standards of good practice for UK-listed companies.

The code warns against excessive executive pay packages. The 'supporting principle' of the code's guidelines for the remuneration committees that set executive pay states that:

'the remuneration committee should be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.'

The Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 supplements the corporate code, stating that:

'The directors' remuneration report must contain a statement of how pay and employment conditions of emplo yees of the company and of other

Box 1: The UK Corporate Governance Code

The UK Corporate Governance Code was first published in 1998 as the final report of the Committee on Corporate Governance chaired by Sir Ronald Hampel, consolidating the recommendations of the earlier Cadbury Report on corporate governance (1992) and the Greenbury Report on executive pay (1995).

The initial iteration of the code stated that:

'disclosure of individual directors' remuneration has also lent force to the Greenbury Recommendation that "remuneration committees should be sensitive to the wider scene, particularly pay and employment conditions within the company when determining annual salary increases." But it should also be recognised that full disclosure of total directors' emoluments has led to an upward pressure on remuneration in a competitive field.'

In subsequent versions, however, beginning with the 2003 edition adopted the Greenbury recommendation without qualification:

'the remuneration Committee should be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.'

Typically, the Code is updated every two or three years, with subsequent editions published in 2003, 2008, 2010 and 2012.

undertakings within the same group as the company were taken into account when determining directors' remuneration for the relevant financial year.'[18]

In October 2013, amendments to the Large and Medium-sized Companies regulations were published, to support the binding shareholder vote on executive pay mandated in the Enterprise and Regulatory Reform Act. These regulations prescribe certain details that companies must include in their statement of how pay and employment conditions of all employees were taken into account when setting executive pay. The new regulations state that:

The directors' remuneration report must set out (in a manner which permits comparison) in relation to each of the kinds of remuneration required to be set out in each of the columns headed "a", "b" and "c" of the single total figure table the following information –

a / the percentage change from the financial year preceding the relevant financial year in respect of the director undertaking the role of the chief executive officer; and

b / the average percentage change from the financial year preceding the relevant financial year in respect of the employees of the company taken as a whole.[19]

The figures 'a' 'b' and 'c' relate respectively to basic salary; taxable benefits; and performance-related pay received in the relevant year. The regulations also state that:

The directors' remuneration policy must contain a statement of how pay and employment conditions of employees (other than directors) of the company and, where the company is a parent company, of the group of other undertakings within the same group as the company, were taken into account when setting the policy for directors' remuneration.

The statement must also set out:

c / whether, and if so, how, the company consulted with employees when drawing up the directors' remuneration policy set out in this part of the report;

d / whether any remuneration comparison measurements were used and if so, what they were, and how that information was taken into account.[20]

Despite these various requirements, research from corporate governance experts at Manifest shows that the pay ratio between FTSE 100 Chief Executives and their employees increased from 47:1 to 133:1 between 1998 and 2012.[21] As of Autumn 2013, it is too early to judge whether or not the new regulations published alongside the Enterprise and Regulatory Reform Act have had any impact. But the growing pay gap does suggest that the measures contained in the 2008 regulations and the Corporate

[18] HM Government, Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, Part 2, paragraph 4 via http://www.legislation.gov.uk/uksi/2008/410/made
[19] HM Government, The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, para 19 via http://www.legislation.gov.uk/uksi/2013/1981/schedule/made
[20] Ibid para 38-39
[21] Executive Director Total Remuneration Survey, p41

Governance Code are largely ignored by FTSE 100 Companies.

Compliance with laws and regulations

A closer analysis supports the same conclusion. We examined the remuneration report of every FTSE 100 company, to see how pay and employment conditions elsewhere in the group were taken into account when setting executive pay, as legally required by the Large and Medium Sized Companies regulations.

The clearest and most obvious way of demonstrating sensitivity to pay and conditions across the group would be to publish a pay ratio comparing the total pay of the CEO to the pay of the average or lowest-paid worker at the company. This pay ratio; the year-on-year change; and comparison with organisations in similar sectors would show how companies value the contribution of their workers and how they apportion responsibility for the company's success between the small number of executives at the top and the wider workforce as a whole.

Box 2: Pay ratios

Concern about the economic and social effects of unequal pay has generated considerable interest in the concept of pay ratios – pay for the highest paid employee as a multiple of the lowest paid or average employee.

Capping executive pay at a fixed ratio, or requiring companies to disclose the ratio for their organisation, could incentivise business leaders to raise the pay of their lowest-paid employees in order to reduce the ratio, as well as to moderate their own pay.

In the UK, the Trade Union Share Owners voting guidelines identify a 20:1 target as the maximum pay ratio within the companies that they invest. The John Lewis partnership has a maximum 75:1 pay ratio between top and average pay incorporated into their constitution.

In some countries, pay ratios have become part of formal corporate governance structures. In France, the pay ratio between highest and lowest-paid employees of state-owned companies is capped at 20:1. In the USA, the Securities and Exchange Commission published requirements for all listed US companies to publish the pay ratio between their CEO and the average company employee in September 2013. In Switzerland a proposal to introduce a 12:1 maximum pay ratio was defeated in a November 2013 referendum, but 35% of voters supported the motion.

The academic research demonstrating the adverse relationship between high pay ratios within an organisation and organisational performance suggests that a public pay ratio would also be of great value to investors. The ratio would help to identify which companies could face problems with employee engagement, productivity and industrial relations in future, as well as highlighting the extent to which the company's pay policy contributes to social inequality, fostering an unfavourable climate for business across the wider economy.

As of autumn 2013, however, no FTSE 100 company had published a pay ratio comparing the difference in pay between their CEO and their lowest-paid or average worker in their most recent remuneration report. Similarly, no FTSE 100 company provided a comparison showing the year-on-year change in total pay for executives compared to the average or lowest paid worker.

Instead, reporting of how companies take pay across the company into account when setting CEO pay generally suggests a failure to comply with the requirements of the corporate governance code and the Large and Medium Sized Companies regulations. Compliance falls into two broad categories:

1/ Saying not showing: the vast majority of FTSE 100 companies – 84 in total – pay lip service to the idea of showing sensitivity to pay and conditions across workforce but do not provide evidence that they have done so

At best, these companies only make a statement claiming to have considered pay for the wider workforce, or to have sought information on salary increases across the group, when setting executive pay.

Essentially, they use a statement in their remuneration report saying that they have complied with the requirements outlined in the Corporate Governance Code and the Large and Medium Sized Companies Regulations as proof that that they have complied.

Crucially, these companies do not provide any figures comparing pay levels for executives and workers. This makes their claims to have shown sensitivity to pay for the wider workforce meaningless, and represents a failure to comply with the corporate governance code on pay or the Large and Medium-sized companies regulations. Stating in the remuneration report that the company considered pay across the group when setting executive pay (or words to that effect) does not demonstrate sensitivity to the wider workforce without clarifying *how* this was considered, and the effect it had on pay.

Typical statements of the companies in this category were as follows:

'The Committee receives an annual update from the Group HR Director concerning the level of increases awarded to UK employees across]the group'

- Associated British Foods

'The Committee receives regular updates on salary increases, bonus and share awards made to employees throughout the Group. These matters are considered when conducting the annual review of executive remuneration'
- Babcock International

'The remuneration committee considered the reward framework for all employees worldwide'
- Burberry

'Pay and employment conditions across the group are taken into account when setting the remuneration of executives'
- Centrica

'The salaries take into account pay decisions across the group'
- G4S

'The Committee considers the prevailing economic conditions, the market competitiveness of each Executive's package and the positioning and relativities of pay across the broader GSK workforce'
- GSK

'The company's remuneration philosophy is to ensure that all employees are rewarded fairly and appropriately for their contribution'
- SAB Miller

'When making these decisions, the committee is sensitive to pay and employment conditions elsewhere in the company'
- Shire

'in making salary adjustment determinations REMCO considered… the planned average salary increase for 2012 across three major countries – the Netherlands, the UK and the USA'
- Royal Dutch Shell

Box 3: The Market

While some of the companies in this category do go on to suggest that pay at all levels of the company is set by 'the market', this justification for high executive pay and a growing gap between the highest and lowest paid has been repeatedly challenged. For example, research for the High Pay Centre showed that less than 1% of the world's largest 500 companies recruited their lead executive by poaching the CEO of an international rival, putting paid to the myth of the international market for executives. Therefore, it is completely inadequate to use this spurious 'market' to justify controversial pay ratios.

Without data showing the level or increase of executive pay relative to ordinary workers, it is impossible to argue that these statements represent compliance with the corporate governance code or the Large and Medium Sized Companies Regulations.

Any company can say that they 'consider' or 'take into account' pay

[22] Executive Director Total Remuneration Survey, p4
[23] Based on Executive Director Total Remuneration Survey and media reports of pay in 2011. For example, see: Guardian, Shire chairman took home £8.5 million, 22 March 2012 via http://www.theguardian.com/business/2012/mar/22/shire-chairman-matthew-emmens-shares; and Independent, SAB Miller's Graham Mackay bags £14m, 24 June 2013 via http://www.independent.co.uk/news/business/news/sabmillers-graham-mackay-bags-14m-8671480.html. Figures for Angela Ahrendts based on Burberry Annual Report 2010/11 via http://www.burberryplc.com/documents/results/2011/10-06-11_annual_report_2010-2011/full_annual_report.pdf – detailing Angela Ahrendts total pay (p79) and share options exercised (p84)
[24] Daily Mirror, Britain's greediest bosses: Fatcat Felix Vulis tops our name and shame list, 10 June 2013 via http://www.mirror.co.uk/money/city-news/britains-greediest-bosses-fatcat-felix-1942612

for wider employees when setting executive pay, or cite input provided to the remuneration committee by the human resources department. To actually demonstrate sensitivity requires an explanation of specific pay differentials, why these are fair and proportionate, and how workers were consulted over the process.

Worryingly, though claims to have received updates on pay and conditions across the group from relevant departments are largely meaningless without concrete data on pay packages for executives and ordinary workers, they could be sufficient to comply with the Autumn 2013 regulations. These regulations require companies to sho how they consulted with employees over executive pay. It maybe that some companies present updates from the human resources department as a form of consultation..

Pay for the three-highest paid FTSE CEOs Angela Ahrendts (Burberry), Angus Russell (Shire) and Graham Mackay (SAB Miller) illustrates how weak existing regulations have proved in terms of containing the pay gap between executives and ordinary workers.

It is legitimate to argue that paying executives such large sums of money, so many times the size of ordinary workers' salaries, might be considered insensitive. Equally, pay increases of this size are unlikely to have been replicated across all Burberry, Shire and SAB Miller workers and could easily have stoked considerable resentment. So although these companies claim to have shown sensitivity to pay and employment conditions elsewhere in the company when setting executive pay, the evidence suggests that this is not the case.

Similarly, Nick Buckles, former CEO of G4S, was criticised by the Daily Mirror for having the third highest pay ratio of any UK listed company, with a £2.3 million pay package reportedly worth 308 times the average G4S employee.[24] This came despite the well-published problems for G4S including a well-publicised 65% fall in profits. Again, it is highly likely that low-paid G4S employees would have felt

table 2 **Relative pay of the UK's top 3 executives**

CEO	Pay (2012)[22]	Pay as multiple of average UK worker	Pay as multiple of annualised minimum wage	Estimated pay increase in 2012[23]
Ahrendts (Burberry)	£16.9 million	638	1288	231%
Russell (Shire)	£12.2 million	460	927	96%
Mackay (SAB Miller)	£9.7 million	366	739	65%

undervalued and unfairly treated by the huge difference in pay levels and the lavish reward for mediocre performance accruing to the Chief Executive. While the company claim that 'pay decisions across the group' were a factor in determining Buckles' pay, there is an unexplained inconsistency with reports that the gap between his pay and that of ordinary G4S employees was the third highest on the FTSE.

These examples show that the 84 companies identified in this category cannot be said to have shown due consideration to pay and conditions across the workforce. Boiler-plate proclamations of sensitivity or consideration, made without any supporting evidence of how these virtues were applied in practice, do not constitute an acceptable explanation of a continuously rising pay gap between top executives and ordinary workers.

2/ Not the whole story: 16 FTSE 100 companies do compare salary increases of Directors to those of the wider workforce and provide concrete figures comparing salary increases for executives and ordinary employees. But in each case, these figures refer to base salary only.

Salaries account for the majority of ordinary workers' pay, but barely a quarter of executive pay packages once bonuses, long-term incentives and other payments are taken into account.

Therefore, salary comparisons do not show the true pay gap between executives and ordinary workers. As the corporate governance code specifically mentions 'salary increases, these companies could be said to be complying with the letter of the code. But because they do not make any attempt to explain or address the growing pay gap between the executives and the rest of the workforce, they do not comply with its spirit.

Equally, they remain in breach of the Small and Large Companies regulations, which refers to 'pay' rather than just salary.

Typical statements of these 16 companies were as follows:

'For 2012 and 2013, the rate of basic salary increase for the chief executive and the finance director has been the same as or lower than the general increase for the UK employee population (at 4% and 0% respectively)'

- Anglo American

'The percentage salary increases awarded to the Executive Directors were below the average percentage base salary increases awarded across the Group.'

- BG Group

'The CEO will not receive a salary increase at this time. The CFO received a salary increase of 2.5%...in line with those across the wider workforce'

- Easyjet

'The Committee also takes into account pay conditions throughout the Group in deciding executive annual salary increases. The average increase for established Executive Directors last year was 2.4%. The average increase for senior management below Board level last year was 2.4%, and for other employees the average increase was typically around 2.5%.'

- Tesco

These statements only compare the change in remuneration levels for executives and workers. There is no comparison of absolute levels of pay. This assumes that the existing pay gap between workers and executives is sensitive and proportionate and that only a dramatic increase would be unfair or insensitive.

Given that the average pay ratio for a FTSE 100 CEO compared to their average employee is already 133:1 (the figure is as high as 380:1 for some companies) this is a flawed assumption.

It would be perfectly possible for a company to significantly reduce the pay of an executive relative to the wider workforce, but maintain a gap in pay that the workers might consider unfair or insensitive. The average FTSE100 ceo:average employee pay ratio in 1998 was 47:1, so even if the current ratio were halved, it could still leave workers feeling that they were unfairly rewarded relative

table 3 **FTSE 100 CEO salary relative to pay for average FTSE 100 company employee**

Year	Average FTSE 100 CEO salary/£	Increase in average salary	Ave employee pay/£	Increase	CEO salary as Multiple of average employee
2003	659,000	6%	24,767	2%	27
2004	672,000	2%	25,955	5%	27
2005	716,000	7%	27,254	5%	26
2006	711,000	-1%	30,828	13%	23
2007	755,000	6%	25,677	-17%	29
2008	810,000	7%	30,994	21%	26
2009	818,000	1%	32,521	5%	25
2010	825,000	1%	34,176	5%	24
2011	850,000	3%	35,744	5%	24
2012	862,000	1%	33,967	-5%	25

to executives in comparison with recent history.

Secondly, all comparisons listed in remuneration reports only relate to basic salaries for executives.

For the average FTSE 100 executive, base salary only forms around 20% of total pay.[25] So any change in base salary does not necessarily reflect the change in total remuneration. As Table 3 show FTSE 100 executive salaries have increased broadly in proportion to the pay of their average employee since 2003.

However, increases in bonuses, stock options and long-term incentive plans mean that total pay has increased by an average 6% year for FTSE CEOs compared to just 3% for their average employee see table 4. This means that the gap between executives and their workers has continued to widen over the past decade.

Therefore, the proportionate salary increases reported in company remuneration reports obscure a growing gap between pay of top executives and that of ordinary workers. Moderate executive salary increases have been set against significant increases in so-called bonuses and long-term incentive plans. At Easyjet, for example, the remuneration report notes that CEO Carolyn McCall's salary has not increased since 2010. However, it was reported that her total pay would increase by 25% in 2012 once bonuses were taken into account, compared to the average

[25] Executive Director Total Remuneration Survey, p12
[26] Ibid, p41-42: These figures differ from those outlined in table 2, because they refer to remuneration awarded, rather than received. We have used these figures because of the greater availability of historic data

table 4 **FTSE 100 pay ratios[26]**

Year	Average FTSE 100 CEO total pay/£	Increase in average total pay	Ave employee pay/£	Increase	CEO pay as Multiple of average employee
2003	2,786,143	7%	24,767	2%	112
2004	3,087,028	11%	25,955	5%	119
2005	3,304,533	7%	27,254	5%	121
2006	3,308,814	0%	30,828	13%	107
2007	3,876,921	17%	25,677	-17%	151
2008	3,958,000	2%	30,994	21%	128
2009	3,895,000	-2%	32,521	5%	120
2010	4,245,000	9%	34,176	5%	124
2011	4,770,946	12%	35,744	5%	133
2012	4,516,474	-5%	33,967	-5%	133

2.5% increase for the wider Easyjet workforce cited in the annual report.[27] Even this increase fails to take into account the value of McCall's longer-term performance incentives.

As the corporate governance code specifically states that remuneration committees should demonstrate sensitivity to the wider workforce when 'determining annual salary increases' companies that compare salary increases, for executives and the workforce as a whole are technically compliant with the code, at least to some extent.

However, the key lesson that policymakers, regulators and investors should learn from this is not that these companies are models of compliance.

By focusing on salaries, they contravene the Large and Medium Sized Companies Regulations. The regulations require companies to show how they considered pay and conditions across the workforce when setting executive pay, implying total pay, rather than just base salary.

The requirement to show sensitivity to pay and conditions of the wider workforce is designed to safeguard employee morale within a company and protect against a growth of socially and economically damaging gap between top earners and the rest of society. None of these aims can be achieved if basic salaries increase proportionally for all workers, but additional incentives and bonuses mean that the total pay of executives grows much faster than that of the average worker.

The Autumn 2013 regulations may make some difference to this, because they require companies to include annual bonuses when comparing CEO pay increases to those of ordinary workers. However, this still ignores longer-term performance-related pay, awarded for performance over 3-5 years, the single biggest component of executive pay.

Research by Income Data Services in Autumn 2013 found that FTSE 100 Directors pay grew by 14% in 2012, despite a small rise in salaries and a fall in annual bonuses, because of a 58% increase in long-term performance-related pay awards.[28] This increase would be completely missed in comparisons between executive and workers' pay under the new reporting requirements.

[27] Independent, Easyjet CEO sees her pay soar, 5 December 2012 via http://www.independent.co.uk/news/business/news/easyjet-ceo-sees-her-pay-soar-8387020.html

[28] Politics.co.uk, Post-recession Britain: Exec pay jumps 14% while average wages increase by just 0.7%, 18 November 2013 via http://www.politics.co.uk/news/2013/11/18/post-recession-britain-exec-pay-jumps-14-while-average-wages

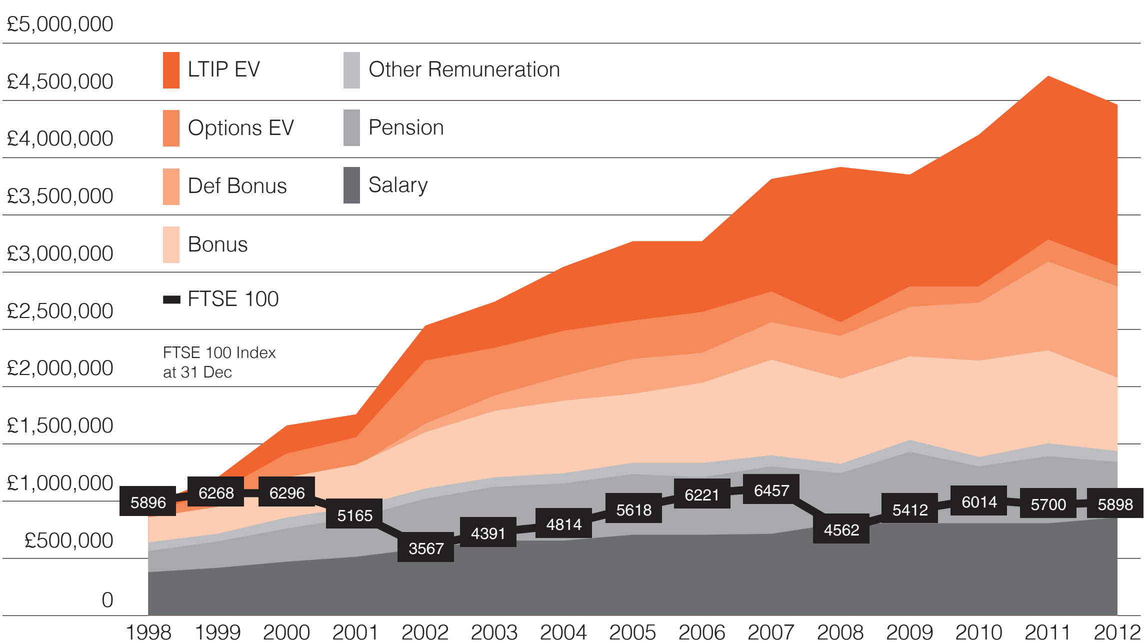
Conclusion

Most FTSE 100 companies pay lip service claim to have considered pay for their wider workforce when setting executive pay, as required by the Large and Medium Sized Companies Regulations and the Corporate Governance Code. A minority of FTSE 100 companies could be said to comply in part, with the letter of the corporate governance code's requirement to show sensitivity to pay and conditions across the wider workforce.

However, no FTSE 100 company shows the difference in pay between their executive and their workers, nor do they explain why this is fair, proportionate or commercially sensible in a way that would be a meaningful demonstration of sensitivity to pay across the workforce. The new measures outlined in October 2013 alongside the Enterprise and Regulatory Reform Act will not address these failings. Meanwhile, the gap between big company executives and their workers continues to widen.

In fact, the failure of the Corporate Governance Code to cover total executive pay, together with its recommendations on performance pay, have actually helped to drive total pay upwards, with no benefits for investors or the wider economy. In addition to specifically suggesting that salary – and not total pay – should relate to pay across the wider workforce, the code states that

figure 1 **Executive pay versus value of FTSE 100, 1998-2012**



'a significant proportion of executive directors'

remuneration should be structured so as to link rewards to corporate and individual performance.

So-called performance related pay for FTSE 100 CEOs has increased rapidly, both in absolute terms and in relation to base salaries, since the introduction of the code, even though performance over this period was unexceptional - the value of the FTSE 100 index remained largely flat between 1998 and 2012.

As Figure 1 shows, it this increase in performance-related pay that is largely responsible for the near 400% increase in executive pay over the past 15 years. Prior to 1998, performance-related bonuses (in orange) and incentive plans formed a much smaller proportion of executive pay packages.

Base salaries formed the bulk of total executive pay when the corporate governance code was introduced.

Therefore, it is possible that the code's reference to showing sensitivity to pay and conditions for the workforce when setting executive pay was essentially intended to reduce, or at least stabilise, the growing pay gap between executives and ordinary workers.

Instead, it has contributed to the growth of incentives and bonuses that has further exacerbated the gap.

The fact that companies are interpreting these requirements and regulations so liberally demonstrates that much stronger safeguards are needed to prevent the gap between the super-rich and the rest from widening further.

As such, we recommend that the corporate governance code be amended to require companies to relate pay for their wider workforce to the total pay of their lead executive, not just their base salary and annual bonus.

This could be changing the current wording:

'the remuneration Committee should be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.'

to the following:

'the remuneration Committee should be sensitive to pay and conditions elsewhere in the group when setting directors' pay. The Committee should aim to reduce the gap between total pay received by their lead executive and the full-time equivalent annual pay of the company's lowest paid worker'

This would provide clear guidelines for companies on executive pay, and safeguard the interests of investors, the UK economy and wider society. The corporate governance code is not legally binding, but operates on a 'comply or explain' basis, so this new wording would allow sufficient companies flexibility to increase their pay ratio in exceptional circumstances, as long as they could provide reasoned evidence for doing so.

We also recommend that Government should require listed companies to disclose the pay ratio between their highest and lowest paid employee.

This would follow the US example, supporting accurate and meaningful reporting of the requirement to relate pay of executives to that of the wider workforce. It would provide a definitive supplement to the requirement in the Large and Medium Sized Companies Regulations to show how companies take pay across the wider workforce into account when setting executive pay. Currently, this requirement is clearly too vague.

Mandatory pay ratio disclosure would also inform public understanding of the scale of pay ratios and enable meaningful historical and sectoral comparisons of relevance to stakeholders. These could include investors, employees and the general public with an interest in fair distribution of pay; positive industrial relations; employee morale; or ethical consumption choices.

The fact that a similar measure is planned for the USA suggests that this is a sensible, business-friendly proposal likely to become more common across market economies where the gap between pay for top earners and low/middle income households has become problematic.

Unlike the US, we propose a ratio that would compare pay between CEO pay and the lowest paid worker, rather than the average.

Firstly, this would go some way to mitigate the pay policy of large investment banks, where a high number of extremely generously paid employees could distort an average. Secondly, it would demonstrate the true scale of income inequalities.

The publication of a pay ratio is in-keeping with the principle of transparency and providing shareholders with the tools they need to address excessive and disproportionate executive pay.

Given that the 2013 Large and Medium Sized Companies Regulations already mandate companies to report on relative pay increases, asking them to provide a total pay ratio would not constitute an additional reporting burden.

Though the business lobby are likely to resist these measures, three decades of rising inequality; falling confidence in business leaders; and widespread public anger at perceptions of a tiny elite controlling the economy in their own interest justifies a stronger response than either the Coalition Government or its predecessor have enacted.

Many mainstream commentators have admitted that public anger at excessive executive pay threatens the public consent that capitalism depends on. The former CEO of Greggs, Sir Mike Darrington, has launched a campaign 'pro-business, against greed' to promote fairer pay distribution from a business perspective. Ferdinand Mount, former adviser to Prime Minister Margaret Thatcher, authored a 2012 book, the New Few, warning of the threat posed to social cohesion by the runaway growth of top pay. Simon Walker, Director General of the Institute of Directors, has admitted that public concern at undeserved rewards for those at the top *'has clearly spread well beyond the professional anti-capitalists in their Occupy tent cities and into the wider population.'*[29]

In this light, measures to address the growing income disparities within UK companies should be seen as pro-business, while the corporate lobby groups who remain the biggest barrier to the kind of reforms we outline, may need saving from themselves.

[29] Institute of Directors, IoD Director General speech on the challenges for capitalism, 13 March 2013 via http://www.iod.com/influencing/press-office/press-releases/iod-director-general-speech-on-the-challenges-for-capitalism