CHASM | Centre on Household Assets and Savings Management

Briefing Paper

'Crony capitalism'? Remuneration Committees and Executive Pay

There is widespread concern that the pay-setting process for top executives in the UK's largest-listed companies has been 'broken'. Far from producing optimum outcomes, politicians and the media contend that it has brought 'excessive' reward over the past decade[1]. A leading factor, they maintain, is the 'cronyism' that pervades the groups making the decisions. Remuneration committees are 'closed shops of vested interests'; senior executives from major companies are sitting as non-executive directors (NEDs) on others sub-boards and boosting each other's pay, even in times of under-performance.

But does this closed-shop claim stand up to scrutiny? Much depends on the research population and the characteristics considered. Manifest, the corporate research group, argues that in terms of numbers of *current* top managers there's little supportive evidence. Its analysis of FTSE All-Share reports in January 2012 shows that only 7.4% of 1,323 executive directors sit on the remuneration committees of other blue-chip companies, while in the case of FTSE100 companies it's just 5%[2].

High Pay Centre research, however, reveals more of consequence. Widening membership characteristics to include *former* as well as current FTSE100 executives (December

[1] See Briefing Paper
[2] blog.manifest.co.uk/2012/01/5494.html
3High Pay Centre (2012) *The New Closed Shop:Who's Deciding on Pay?* www.highpaycentre.org.uk

2011/January 2012 reports), pushes representation up to 46% and when extended to individuals with 'business or financial intermediation backgrounds' to 90%. It also highlights the fact that women remain significantly under-represented occupying just 16% of seats and are absent from 45% of committees[3].

What about the contention that these sub-boards are awarding exorbitant sums to each other's executives? The Centre's research hints at this, speculating that such collusion is *possible*, but eschews a stronger link. Its caution is well-founded and on two grounds; its own data is limited to partial biographical profiles and other more detailed analyses of executive reward (including some of its own investigations) paint a somewhat different picture.

The HayGroup's research speaks for a number of these studies in maintaining that rather than a system of consensual patronage, sub-boards are loci of conflicting interests. Reward packages are outcomes of *negotiated settlements* both inside sub-boards and externally, involving executives, key institutional investors and HR/finance directors, with consultants shadowing and advising on options[4].

So if cronyism is not key, how are the massive increases in earnings to be explained? Most accounts appeal to a cluster of multi-layered drivers. Chief among these are: a facilitating culture in which directors' income has been detached from the restraining influences of earnings relativities; the increased value of variable pay (with easily attainable bonuses and incentive schemes, and generous metrics); the 'short-termism' of packages (with 2-3 year

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[4] *HayGroup (2012) The Trouble with Executive Pay www.haygroup.co.uk*

vesting periods for shares); the depleted powers of institutional shareholders because of the dispersion of ownership in UK equity markets and, finally, the influence of remuneration advisors (often seen as creating ‘an international executive talent market’, and the source of unsophisticated benchmarking and performance measures).

Doubtless future research, with access to committee pay-setting processes, will be able to refine the fluctuating significance of these factors and the overall role of remuneration sub-boards, but it will take detailed longitudinal analyses to finally expunge the rhetoric of conspiring groups.

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