



THE  
HIGH PAY  
COMMISSION

# Cheques With Balances: why tackling high pay is in the national interest

**Final report of the High Pay Commission**

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## About The High Pay Commission

**The High Pay Commission is an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK. The Commission was established by Compass with the support of the Joseph Rowntree Charitable Trust.**

The Commission is independent from any political party or organisation. It is non-partisan in its approach and will draw conclusions based solely on the findings of the Commission.

Over the last 30 years pay at the top has increased, and pay differentials have grown. The Commission provides an opportunity to explore and understand the drivers behind this trend and to look at its effects. It will also seek to look at reforms that could to mitigate or reduce this trend.

The Commission will run for one year from November 2010.

For more information visit:  
[www.highpaycommission.co.uk](http://www.highpaycommission.co.uk)

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## Commissioners

**The Commissioners are business, trade union, and civil society representatives. They are drawn from a range of backgrounds and represent a cross section of political interests. All of the commissioners serve in an individual capacity and not as representatives of the organisations for which they work.**

**Deborah Hargreaves (Chair)** is the former business editor of the Guardian, a post she held from 2006 to 2010. She previously worked at the Financial Times where she was news editor and before that, financial editor. She held a variety of posts over 19 years at the FT including personal finance editor and as a foreign correspondent in Brussels and Chicago.

**Brian Bailey** is the director of pensions for the £8.0 billion West Midlands Metropolitan Authorities Pension Fund. Brian has also held a number of company non-executive directorships and was for many years an audit committee member of two US private equity funds. He currently holds a non-executive directorship of PIRC Limited together with the honorary treasurer role for LAPFF (Local Authorities Pension fund Forum).

**Lord Richard Newby** is Co-chair of the Liberal Democrat Parliamentary Treasury Committee, having been the Party's Treasury spokesman in the Lords since 1999. He worked as Director of Corporate Affairs of Rosehaugh plc. He now advises companies and other organisations on corporate responsibility issues.

**Frances O'Grady** is the Deputy General Secretary of the TUC. Frances has lead responsibility for a wide range of key areas of policy development across the TUC's work including trade union recruitment and organisation, inter-union relations and TUC services to members.

**Robert Talbut** is the Chief Investment Officer, for Royal London Asset Management. His career in asset management has seen him take on a wide variety of portfolio management roles of both a retail and institutional nature. Prior to RLAM Robert was the Chief Investment Officer of the ISIS Group retaining direct responsibility for a number of retail and institutional funds while helping to create a new investment team.

**Professor Michael Taylor** was Director of Christian Aid for twelve years from 1985–97. He was closely involved in the creation of the Centre for the Study of Global Ethics and was President of the Jubilee 2000 Debt Campaign and chairs several NGOs. He is Emeritus Professor in Social Theology at University of Birmingham.

# Contents

<b>7</b>	<b>Foreword by Deborah Hargreaves</b>
<b>8</b>	<b>Executive summary</b>
<b>16</b>	<b>1   Introduction</b>
<b>22</b>	<b>2   Is the flood to the top a problem?</b> 2.1 The business case for fair pay 2.2 The economic case for fair pay 2.3 The social case for fair pay
<b>38</b>	<b>3   Where now?</b> 3.1 Transparency 3.2 Accountability 3.3 Fairness
<b>69</b>	<b>4   Conclusion</b>
<b>70</b>	<b>Annexes</b> 1 The expert panel 2 People the Commission met 3 Information on data

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# Foreword

DEBORAH HARGREAVES,  
CHAIR OF THE HIGH PAY COMMISSION

As Britain enters times of unparalleled austerity, one tiny section of society has been insulated from the downturn. That is the top 0.1% of earners, with company directors in particular continuing to enjoy a huge annual uplift in rewards.

The High Pay Commission has spent the past year exploring this growing division between those at the very top and everyone else. Our investigation has led us to conclude that excessive top pay is deeply damaging to the UK as a whole, and action is urgently required to address it.

Our work has shown that we must now break open the closed shop that sets pay for our top directors and get back to basics for executive pay. It is clear that we must open up top pay to more scrutiny from a cross-section of society. To do this, our report sets out a 12-point plan based on the principles of accountability, transparency and fairness.

The public is rapidly running out of patience with a system that allows those at the top to enrich themselves while everyone else struggles to make ends meet. This has been thrown into stark relief by the economic crisis, but has been building for the past 30 years.

In 1980 top bosses were well rewarded, but they had not pulled so far away from the rest of society. Since then some of them have enjoyed an increase of over

4000% to what are now multi-million pound packages.

Those in respectable middle class jobs such as secondary school teachers and policemen have seen their income rise by a much more modest amount with average wages increasing from £6,474 to just £25,900 over the same period.

There have been huge changes in all of these jobs, yet so much wealth has been channelled to those at the very top. This is a trend that has led to such a huge rise in inequality over the period that Britain now has a gap between rich and poor that rivals that in some developing nations.

The High Pay Commission has sought to understand these social trends and explore why they matter. Fairness is a concept close to the heart of the British people and it is essential that we now redress the balance.

All three political parties have recognised the need to tackle top pay. Ministers and politicians have spouted much rhetoric about fairness. We are calling on them to take this agenda forward.

We must now halt the trend towards greater inequality before we end up back at the levels of disparity evident in Victorian England.

# Executive summary

The High Pay Commission's year-long inquiry into pay at the top of UK companies has found evidence that excessive high pay damages companies, is bad for our economy and has negative impacts on society as a whole. At its worst, excessive high pay bears little relation to company success and is rewarding failure.

This distortion creates an impression that business leaders are 'in it for themselves' and is damaging trust in British companies, especially at a time when most workers are seeing little or no increase in their pay.

We have found that decisions leading to escalating high pay for senior executives are often concealed from shareholders and the public within complex remuneration arrangements, buried in the small print of companies' annual reports. This lack of transparency adds further to the impression that senior company executives are 'rigging' the system for their own ends.

Our findings also show that the argument used by many senior figures in British

business, that pay must escalate in order to attract the best talent from abroad to UK companies, is a myth. Our own evidence shows that global mobility is limited, with only one successful FTSE 100 chief executive officer poached in five years – and even this person was poached by a British company.

This report, the final report from the High Pay Commission, makes 12 recommendations to address what we see as a crisis at the top of British business. We believe it is time to act to build transparency, accountability and fairness into remuneration for senior executives in the UK.

Previously unpublished figures show that pay at the top has spiralled alarmingly to stratospheric levels in some of our biggest companies. In BP, in 2011 the lead executive earned 63 times the amount of the average employee. In 1979 the multiple was 16.5. In Barclays, top pay is now 75 times that of the average worker. In 1979 it was 14.5. Over that period, the lead executive's pay in Barclays has risen by 4,899.4% – from £87,323 to a staggering £4,365,636.

## Gross inequality

During the last 30 years rewards have been flooding upwards, with far more modest returns going to the average employee. Since the mid 1970s, the general workforce's share of GDP had shrunk by over 12% up to 2008.<sup>2</sup>

In UK companies today, the pay gap between bosses and the average employee has grown dramatically. In the last year alone, as economic growth has slowed, executive pay in the FTSE 100 rose on average by 49% compared with just 2.7% for the average employee.

Since the financial crisis of 2007 we have seen the foundations of the current economic model shaken to the core.

There is now a strong sense of injustice at the fact that those at the top of our companies continue to reap significant rewards, while the wages of many ordinary workers are cut in real terms and their jobs become more uncertain. Since 2007, a million more people are unemployed, the workless household rate has increased by 5% and nearly a million young people aged 16–24 are on the dole.<sup>3</sup>

<sup>1</sup> Data provided for the High Pay Commission By Incomes Data Services see annex 3 for necessary caveats. (repeated in Table 2)

<sup>2</sup> J. Plunkett (2011) Growth without Gain. Resolution Foundation [http://www.resolutionfoundation.org/media/media/downloads/Growth\\_without\\_gain\\_Web.pdf](http://www.resolutionfoundation.org/media/media/downloads/Growth_without_gain_Web.pdf) p23.

<sup>3</sup> Office for National Statistics (2011) Labour Force Survey.

TABLE 1 COMPANY PAY DATA IN UK LISTED COMPANIES 1979–2011<sup>1</sup>

Company name	Director's pay 1979–1980	Lead executive actual total earnings 2009–2011	Total earnings increase 1980–2009/11	Top pay as multiple of average pay 1979–1980	Lead executive total earnings as multiple of average pay 2009–2011
Lonmin	£224938	£1865342	729.3	44.1	113.1
BP	£143334	£4452624	3006.5	16.5	63.2
Barclays	£87323	£4365636	4899.4	14.5	75.0
GKN	£81000	£1534221	1794.1	14.9	47.7
Lloyds Banking Group	£79344	£2572000	3141.6	13.6	75.0
Reed Elsevier	£75209	£2028108	2596.6	13.3	38.4

## Damaging trust

Against this backdrop, the growing pay gap with rewards meted out to those at the top, often for failure, has increased a public disillusionment and distrust of business. When executive rewards seem to go beyond what is linked to that executive's contribution to the success or welfare of the company, it damages public trust and contributes to an attitude that business leaders are 'in it for themselves'.

The proposed increase during the recession in the salary of Sir Martin Sorrell of 50% from £1 million to £1.5 million, after he has said that 'inequality, the concentration of wealth is a serious issue', reinforces the view of 'them and us'. For business, there is no quick fix. Trust takes time to build and is easily damaged.

Employee engagement is a significant determining factor in business success and research suggests that pay equity influences aspects of lower-level employee motivation, commitment to management goals, effort and cooperation. In a survey of executives globally, 84% said that 'disengaged employees' are one of the three biggest threats facing their business.<sup>4</sup>

<sup>4</sup> Economist Intelligence Unit (2010) Re-engaging With Engagement: views from the boardroom on employee engagement, [www.businessresearch.eu.com/sites/businessresearch.eu.com/files/LON%20-%20PL%20-%20Hay%20report\\_WEB.pdf](http://www.businessresearch.eu.com/sites/businessresearch.eu.com/files/LON%20-%20PL%20-%20Hay%20report_WEB.pdf).

## Hidden from view

Our inquiry has also found that pay is too often seen as an opaque and specialised part of company behaviour isolated from the rest of the business. Yet the flaws our investigation have highlighted in corporate governance, boardroom behaviour and the mismanagement of power inherent in placing control in the hands of an increasingly disparate range of owners do not simply apply to pay.

We have also found attempts to 'camouflage' executive pay. Ever more complicated pay arrangements hidden within reams of remuneration reports appear designed to obfuscate as much as they reveal. This lack of clarity and decline in transparency, from shareholders and owners of businesses as well as from the public, encourages a sense of distrust when the truth comes out, as it so often does.

## Distorting the market

Further, our investigation has found that top pay is a symptom of market failure based on a misunderstanding of how markets work at their best. Within companies, fair pay matters. It affects productivity, employee engagement and trust in our businesses. Pay in publicly listed companies sets a precedent; when it is patently not linked to performance, or rewards failure, it sends out the wrong message and is clearly a symptom of a poor functioning market. In addition, high levels of inequality in income contribute to sectoral imbalances, regional disparities and asset bubble inflation.

Between 1998 and 2007, 60% of the rise in overall income share of the top 10% went to finance workers. It is not surprising, then, that many talented individuals chose to make their career in the City.<sup>5</sup> Not surprising, also, that this economic imbalance has drawn talent away from other sectors.

## Creating instability

But top pay is also a story about the health of society. More unequal societies have lower levels of social mobility.<sup>6</sup> Indeed, when the gap between the 'haves and have nots' becomes so large, it does not encourage aspiration or cohesion, but disengagement and social unrest. Academics warn that inequality can lead to political instability, with poorer groups pursuing their economic objectives outside the mainstream.

Our inquiry has found that we are now at a tipping point where company reputations hang in the balance, and our economy and society is undermined by allowing the situation of excessive high pay to persist.

Although this must ultimately be a longer term endeavour as businesses, politicians and the public engage, it has become clear that our starting point in seeking these solutions should be based on the key principles of transparency, accountability and fairness.

<sup>5</sup> W. Hutton (2010) Hutton Review of Fair Pay in the Public Sector: interim report.

<sup>6</sup> R. Wilkinson and K. Pickett (2009) *The Spirit Level: why more equal societies almost always do better*, Penguin

# The High Pay Commission's recommendations

## Prime Minister David Cameron, Leader of The Conservative Party

On 27 October 2011, Prime Minister David Cameron said, 'Everyone, whether they are in public life, whether they are in private enterprise, they've got to be able to justify the decisions they make about pay.'

He said pay decisions should be published, and transparency improved. Boards should also be more accountable to shareholders and consider the wider implications of their actions: 'Boards have got to think when they make pay awards if it is the right and responsible thing to do... I believe in a responsible society, and that is responsibility exercised by everybody, including in the boardroom.'

## Nick Clegg, Deputy Prime Minister and Leader of the Liberal Democrats

'I think some of them [pay awards] are incomprehensible and will strike most people as a slap in the face for millions of people who are on normal incomes and struggling to make ends meet.'

'Too often there isn't enough accountability. Shareholders don't know what's going on and how these decisions have been arrived at and crucially there isn't a close enough relationship between high pay for people at the top and the performance of the company itself.'<sup>7</sup>

## Ed Miliband, Leader of the Labour Party

After calling for employee representation on the remuneration committees of all publicly listed companies in his Labour Party Conference speech 2011 Ed Miliband stated more recently that: 'when people are struggling, when the middle is being squeezed, when people are seeing their living standards fall, it is not fair for those at the top to get runaway rewards not related to the wealth they have created.'<sup>8</sup>

<sup>7</sup> Nick Clegg (2011) <http://www.bbc.co.uk/news/uk-politics-15503060>

<sup>8</sup> Ed Miliband (2011) <http://www.labour.org.uk/directors-pay-shows-why-economy-needs-to-change,2011-10-28>

## TRANSPARENCY

### 1 Pay basic salaries to company executives

The High Pay Commission believes pay packages have become increasingly complex, damaging relations with shareholders, creating misperceptions and encouraging confusion and obfuscation. We therefore call for executive pay to return to first principles. **We recommend executives should be paid a basic salary, with remuneration committees electing to award one additional performance-related element only where it is absolutely necessary.**

### 2 Publish the top ten executive pay packages outside the boardroom

The High Pay Commission believes that lack of transparency in pay directly below board level hides both the impact of ballooning top pay on other executives and its link to performance. **We therefore call on all companies to publish an anonymised list of their top ten highest paid employees outside the boardroom.**

### 3 Standardise remuneration reports

The High Pay Commission has found remuneration reports to be complex, making pay packages and awards opaque and unclear for shareholders and the public. **We recommend that remuneration reports should be presented in a standardised format, incorporating and moving beyond best practice. As part of this we recommend that all companies**

**publish a figure for the total remuneration package received by each executive and a methodology for how it has been calculated.**

### 4 Require fund managers and investors to disclose how they vote on remuneration

The High Pay Commission acknowledges that, while the current model allows shareholder absolute oversight of the executive through voting rights at the annual general meeting, some investment fund managers fully disclose how they vote on corporate governance while other only disclose this information to clients. **We therefore call on all investments fund managers to fully disclose how they vote on all issues including those of remuneration.**

## ACCOUNTABILITY

### 5 Include employee representation on remuneration committees

The High Pay Commission has found remuneration committees to be a closed shop, made up largely of current and recently retired executives. This model has failed, leading to spiralling pay. We believe that greater engagement with employees may help restrain executive pay and help mitigate negative impacts on morale as well as encourage a greater engagement with the workforce. **We therefore call for employees to be represented on remuneration committees as a first step to better engagement and accountability.**

## 6 All publicly listed companies should publish a distribution statement

The High Pay Commission has found that many shareholders have a low level of engagement on issues of executive pay. It is important now to encourage greater engagement through improved disclosure, which takes greater account of the company context. **We therefore recommend that all publicly listed companies publish annually a statement of the distribution of income over a period of three years, importantly showing percentage changes in:**

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

## 7 Shareholders should cast forward-looking advisory votes on remuneration reports

The High Pay Commission has considered recommending making shareholders' advisory votes on remuneration reports binding, but it was felt that a preferred option at this stage would be to make the vote forward looking. **We therefore recommend that shareholder votes on remuneration are cast on remuneration arrangements for three years following the date of the vote and that these arrangements include future salary increases, bonus packages and all hidden benefits, giving shareholders a genuine say in the remuneration of executives.**

## 8 Improve investment in the talent pipeline

The High Pay Commission has found that the growing trend in hiring from outside the company is having an escalatory effect on executive pay. We recognise that seamless succession is not only important to company performance, but has a positive limiting effect on pay. **We therefore recommend that companies implement a defined and structured talent pipeline to ensure suitable and qualified successors are promoted from within the company where possible.**

## 9 Advertise non-executive positions publicly

The High Pay Commission recognises that the makeup of non-executive directors, who determine executive pay deals, may have an inflationary effect on pay. Even looked at positively, these non-executives are drawn from a relatively small pool of individuals. **We believe the recruitment of non-executives should be openly advertised, making remuneration committees open to a wider group, encouraging diversity and ending the closed shop culture of appointments.**

## 10 Reduce conflicts of interest of remuneration consultants

The High Pay Commission has found that, despite codes of conduct, remuneration consultants are found to cross sell services to companies, giving them a direct conflict of interests. This may be having an inflationary effect on pay. **We therefore recommend, in the first instance, that companies publish the extent and nature of all the services provided by remuneration consultants, acknowledging this is only the first step if cross selling is seen to continue.**

## FAIRNESS

## 11 All publicly listed companies should produce fair pay reports

The High Pay Commission believes that it is essential that the pay gap between highest paid and the company median should be open to scrutiny, including how the ratios of highest to median pay has changed over a three-year period. If companies produce a fair pay report it will allow them to state their principles in relation to pay, encouraging pay to be considered across the company when setting executive pay, as is required by the UK Corporate Governance Code. **We recommend that all publicly listed companies should publish fair pay reports as part of their remuneration reports to build trust in pay policies.**

## 12 Establish a permanent body to monitor high pay

Our investigations have found that escalating high pay is having a negative impact on company performance, the wider economy and trust in business. We have been shocked at the limited information available to the public, the consequent lack of informed public debate and the deep sense of unfairness that this lack of openness engenders. **We recommend that a permanent body be established on a social partnership basis, much like the Low Pay Commission by government to:**

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

# 1 | Introduction

*You have to realise: if I had been paid 50% more, I would not have done it better. If I had been paid 50% less, then I would not have done it worse.*

Jeroen van der Veer, Former CEO of Royal Dutch Shell<sup>9</sup>

<sup>9</sup> C. Hoyos and M. Steen (2009) 'Shell chief calls for pay reforms', Financial Times, 8 June, [www.ft.com/cms/s/0/d8ed7afa-5458-11de-a58d-00144feabdc0.html#axzz1aGcstYdP](http://www.ft.com/cms/s/0/d8ed7afa-5458-11de-a58d-00144feabdc0.html#axzz1aGcstYdP).

<sup>10</sup> High Pay Commission (2011) More for Less: what has happened to pay at the top and does it matter?, <http://highpaycommission.co.uk/wp-content/uploads/2011/09/HPC-IR.pdf>.

<sup>11</sup> T. Piketty and E. Saez (2006) 'The evolution of top incomes: a historical and international perspective', NBER Working paper No. 11955.

<sup>12</sup> Public sector employees account for less than 1% of the top 1% of the income distribution scale. This was acknowledged in the government inquiry headed by Will Hutton, which looked at high pay in the public sector. It is for this reason that the Commission has focused its attention on the private sector.

Over the past year the High Pay Commission has investigated a sustained trend in income distribution: since the late 1970s there has been a significant shift in income share, with a growing percentage going to the very top.

This ballooning in pay at the top has accompanied a dramatic growth in income inequality, which if it continues unchecked will take us back to Victorian levels of pay inequality in less than 30 years.<sup>10</sup>

No longer the landed gentry nor the successful entrepreneur, the majority of this wealthy elite are now the working rich;<sup>11</sup> bankers and business leaders are profiting the most from this upwards redistribution and it is primarily taking place in the private sector.<sup>12</sup>

In our companies the pay gap between the bosses and the average employee has grown. Starting in the early 1980s a shift occurred in which pay at the top increased exponentially. In part this growth was driven by a desire to link pay to performance – to tie the interests of the executive to the shareholders and create quasi-entrepreneurs at the top of our businesses. Yet despite these attempts to link pay to performance, rewards for failure continue and pay levels appear to be increasingly disconnected from the performance of the company.

Today, as economic growth slows and many workers experience wage freezes, those at the very top have experienced no such hardships. Indeed, their pay has continued its meteoric rise: in 2010

alone executive pay rose by 49% on average in FTSE 100 companies. This is juxtaposed with average employees having an increase in pay of just 2.7% in the same year.<sup>13</sup>

As this report shows, over the past 30 years there has been enormous growth in pay at the top of some of our biggest companies. In BP total pay of executives has increased by 3006%, while over the same period average pay in BP has increased by just 713%. The ratio between the average pay of executives and that of workers has grown from 16 to 63. While data going back this far is rare, the picture repeats itself in all the companies on which we were able to acquire information (see annex 3).

This trend has characterised the last 30 years of economic activity in the UK. Yet it took the financial crisis in 2008 to throw it into stark relief. In doing so it forces us not only to look at what has happened to top pay but also to investigate what is driving it.

## Drivers of pay at the top: the context

The growth in top pay has not taken place in isolation. It demonstrates the dominance of a particular form of capitalism in the UK and an elevation of the concept of the rational self-interested man to unprecedented heights.

In this environment human nature, aspiration and endeavour are seen through a prism of self interest, or as some would put it “greed” as ever larger rewards are required to generate performance from individuals at the top of companies whose predecessors but a generation ago did the job for a tenth of the pay. Yet top pay is not only a symptom of a particular form of capitalism but is also contributing to many of the problems we see in our economy, society and companies.

As has been argued by others, markets do not occur in isolation; they are embedded within broader society.<sup>14</sup> The first companies were licensed to trade by the state and that inter-dependence and the idea of ‘permission to trade’ underpinned company activity until the late 1970s.<sup>15</sup>

Companies served a wide constituency – consumers, clients, employees and the broader public good. A company was in partnership with society.

Even today publicly listed companies are still licensed by the state to operate. They depend on the roads, railway lines, infrastructure, an educated workforce and a willing clientele, and equally they have responsibilities to the countries they work in.

<sup>13</sup> Incomes Data Services (2011) Directors Pay Report.

<sup>14</sup> See J. Kay (2005) The Truth about Markets, Penguin.

<sup>15</sup> See East India Company's First Charter.

In the late 1970s the old corporatism was fading and a new more ‘rational’ form of capitalism was urged on the world by economists such as Milton Friedman from the University of Chicago. These thinkers argued that economies, and the companies within them, should be freed from the rigid exchange controls and trade barriers that hitherto had been a dominating part of the economic landscape.

Freeing capital to move around the world would help companies grow faster, and adapt more energetically to new opportunities; thus we would all benefit. The company, as we know it today, focused on short-term shareholder value was born.

It was argued that to achieve the necessary dynamism those at the top of companies must be incentivised, and their interests must be tied to those of the shareholders. Nothing should stop those capable of generating wealth from so doing. That wealth would then trickle down to the rest of society as the wealth creators spent their rewards, created new jobs, started new companies. After all, it was argued, if free to do so, people will always make rational economic decisions based on self-interest.

Paying the best more and taxing the high paid less became a cornerstone of this economic argument. The wealth creators needed to be freed to create wealth, and if they were not properly rewarded they might go off and do something else with their talents, somewhere else.

For the last 30 years those at the top have seen their pay explode. Rewards have literally flooded upwards with far more modest returns going to the average employee. Indeed, since the mid 1970s, the general workforce’s share of GDP had shrunk by over 12% up to 2008.<sup>16</sup>

Since the financial crisis of 2007 we have seen the foundations of this economic model shaken. A new public mood seems apparent, one that feel a visceral sense of injustice at the fact that while their wages are cut in real terms and their jobs become more uncertain, those at the top of our companies continue to reap significant rewards.

This sense is exacerbated by a public anger at the bankers who are seen by many as culpable for the financial crisis. Moreover, the financial crisis demonstrates the extent to which companies and those who lead them have become disconnected from the consequences of their actions. Fred Goodwin was an exception: few of those at the top of our companies felt the cost of their actions; indeed even Fred Goodwin left RBS with a generous pension package.

In this light, private companies can no longer be seen as autonomous separate bodies that should be left untouched by regulation. There is a growing consensus that the foundations of our economy must change and that the over reliance on the City of London is no longer a sustainable

position. It is against this backdrop that the High Pay Commission has been conducting its investigation into top pay.

Since 2007 a million more people are unemployed, the workless household rate has increased by nearly 5% and nearly a million young people aged 16–24 are receiving jobseeker’s allowance.<sup>17</sup> And yet those at the top of our companies and banks continue to reward themselves astronomically high salaries and bonuses.

This report makes clear that the growing pay gap, rewards meted out to those at the top – while everyone else suffers austerity Britain – and rewards for failure that have characterised recent years are no longer tenable. Fairness matters to individuals, society, companies and the way successful economies operate. Without fairness and trust business cannot function properly.

People at the top are like everyone else. They are not a breed apart. They are motivated by status considerations as much as by pay.<sup>18</sup> They want to be liked and respected by their peers. They have standards of professional ethics. Creating a vision and living by values is what gets them out of bed in the morning. Yet none of this is acknowledged in the way we pay them. Indeed pay structures for those at the very top are based on the assumption that people at the top need to be rewarded to excess to persuade them to do their job.

Quite simply we have been paying too much and getting too little, as our interim report *More for Less* argued.<sup>19</sup>

If we continue in this way we will incentivise the wrong behaviours, continue to fail to match pay to performance, mis-read what makes a successful company tick and damage the standing of business in the public’s eye.

The public have a visceral sense of fairness and top pay stands in stark contrast to it. Talented individuals should do well; the public do not grudge great musicians their rewards, and the risk-taking entrepreneur is seen in a different light from a company man or investment banker who experience only the upside of their gamble.

As pay at the top rises, so too does disillusionment and distrust of business among the public. It is evident in the protests against tax avoidance, and in the person-in-the-street’s disgust that those who got us into the current economic situation are not sharing the pain of it. Sustaining these levels of unjustifiably high pay shows that we are really not “all in this together”.

<sup>16</sup> J. Plunkett (2011) Growth without Gain. Resolution Foundation [http://www.resolutionfoundation.org/media/media/downloads/Growth\\_without\\_gain\\_-\\_Web.pdf](http://www.resolutionfoundation.org/media/media/downloads/Growth_without_gain_-_Web.pdf) p23.

<sup>17</sup> Office of National Statistics, Labour Force Survey  
<sup>18</sup> See H. Minzberg (2009) *Managing*, Berrett-Koehler.  
<sup>19</sup> High Pay Commission, *More for Less*.

## Top pay as a symptom of market failure

Too often pay is seen as a rather opaque and specialised part of a company isolated from the rest of business behaviour. Yet it is through looking at executive remuneration that we see the classic problems of corporate governance laid bare. Nowhere do the conflicts of interest in corporate governance lie so close to the surface.

Our investigation has highlighted the flaws in remuneration committees, the extent of management power and the challenges inherent in placing all control in the hands of an increasingly disparate range of owners. Top pay is a symptom of a wider market failure based on a misunderstanding of how markets work at their best. Though we have only looked at high pay, we have been cognisant of this broader debate and acknowledge that our recommendations are part of a wider solution that would see a new, fairer, more sustainable and more vibrant form of capitalism.

Furthermore, the economic damage from over-paying at the top and under-paying everyone else goes wider. High levels of inequality in income are seen to contribute to sectoral imbalances, regional disparities in investment and asset bubble inflation.

In the current economic environment pay becomes ever more important. It is argued that extremes in pay distribution are dampening our ability to grow out of the crisis. When a bigger and bigger slice

of corporate profit is going to a select group of people who invest in safe assets or commodities (often in other parts of the world), rather than spend their money on goods and services here, economic growth in the UK is stunted.

But top pay is also a story about the health of society. The social impact of gross inequality has been well investigated from the early work of Sir Michael Marmot, and the Whitehall Study, to the more recent findings of Richard Wilkinson and Kate Pickett in *The Spirit Level*.<sup>20</sup> While there is some controversy over their findings, which they have robustly rebutted in peer reviewed journals, there seems to be little doubt that gross inequality affects morbidity and mortality rates, including infant mortality rates. More unequal societies also have lower levels of social mobility. As Conservative Minister Rt Hon David Willetts MP has stated, 'Western societies with less mobility are the ones with less equality too.'<sup>21</sup>

Over the past 30 years, most people supplemented their incomes through credit and paper wealth in the form of equity in property. This has now gone – as the pendulum swings the other way restricting credit to all but the safest of applicants – and spending will remain slow as psychological poverty persists.

As pay escalates for those at the top it creates a new point of comparison – a new norm. Executives look to finance,

finance to private equity, and private equity to footballers – each proclaiming the other is where the problem lies. Yet the dramatic escalation of executive pay is cause for specific concern in our companies and for our economy.

Fair pay within companies matters; it affects productivity, employee engagement and trust in our businesses. Moreover pay in publicly listed companies sets a precedent, and when it is patently not linked to performance, or rewards failure, it sends out the wrong message and is a clear symptom of market failure.

Within the business community there is a blame game going on. Talk to executives and the problem is shareholders; talk to shareholders and the problem is non-executive directors; non-executive directors in turn blame the executive for demanding too much; and everyone blames remuneration consultants for making the whole system too complicated.

This blame game, however, cannot continue indefinitely as there is a growing public disquiet, which threatens to boil over into anger. Business leaders – those who can invest and help us grow out of this crisis – are seen as being on a par with estate agents in the degree of public trust they inspire. That, in the words of John Cridland, Director General of the CBI, the business lobby, 'is not a good space to be in'.<sup>22</sup>

Business leaders universally recognise that employee engagement is essential for a successful company and yet they fail to recognise the negative impact on engagement caused by their own pay. The more thoughtful and engaged corporate executives recognise there is a problem with pay, but feel unable to combat it from within – they are trapped in a system they do not believe works. Time is running out. The public demands change. The economy needs change.

Businesses must take a lead on this issue and elect to introduce the changes in company practice we recommend. But government must act too. Government should introduce the changes recommended in the report; use its power as a purchaser; and set a tax regime that incentivises the sort of behaviour that leads to market success and not market failure.

It took 30 years to reach this point of pay excess. Even with the best ambitions it may take that long to resolve. This problem goes deep. It is a symptom of a particular form of free market capitalism and we should recognise that no single set of policy recommendations will resolve it. Business must work with government, trade unions and civil society to address this problem over the longer term.

It is no longer possible to contest the fact that there has been an enormous upward redistribution of income since the 1980s. Only one question remains – what do we do about it?

<sup>20</sup> See [www.ucl.ac.uk/epidemiology/people/marmotm.htm](http://www.ucl.ac.uk/epidemiology/people/marmotm.htm); Wilkinson and Pickett, *The Spirit Level*.

<sup>21</sup> Quoted in 'Viewpoint: why the class struggle is not dead' (2011) BBC News, <http://www.bbc.co.uk/news/uk-politics-14721315>.

<sup>22</sup> L. Elliott (2011) 'CBI's John Cridland: "There is a sense of urgency about making Plan A work"' Guardian, 15 April, [www.guardian.co.uk/business/2011/apr/15/john-cridland-sense-of-urgency-plan-a-work](http://www.guardian.co.uk/business/2011/apr/15/john-cridland-sense-of-urgency-plan-a-work).

# 2 | Is the flood to the top a problem?

Over the last 30 years as our interim report *More for Less* demonstrated we have seen a dramatic shift in income distribution. Those at the top have done very well – with the top 0.1% seeing the most significant growth, followed closely by the top 1% and top 10%:

- In 1979 the top **0.1%** took home **1.3%** of the national income; by 2007 this had grown to **6.5%**.
- In 1979 the top **1%** took home **5.93%** of the national income; by 2007 this had grown to **14.5%**.
- In 1979 the top **10%** took home **28.4%** of the national income; by 2007 this had grown to **40%**.<sup>23</sup>

In our companies, we see this trend repeated. While the data going back to 1979 is limited, in all the companies for which data was available we found enormous growth in pay at the top, and we provide the figures in Table 2 as an indicative picture of what has happened across FTSE companies. Indeed in the last ten years alone average total pay for the lead executive in the FTSE 350 companies has increased by 108%. The average FTSE 100 CEO is estimated to take home £4.2m.<sup>24</sup>

TABLE 2 COMPANY PAY DATA IN UK LISTED COMPANIES 1979–2011<sup>25</sup>

Company name	Director's pay 1979–1980	Total earnings increase 1980–2009/11 (%)	Lead executive actual total earnings 2009–2011	Top pay as multiple of average pay 1979–1980	Increase in average pay 1980–2009/11 (%)	Lead executive total earnings as multiple of average pay 2009–2011
Lonmin	£224938	729.3	£1865342	44.1	223.5	113.1
BP	£143334	3006.5	£4452624	16.5	713.4	63.2
Barclays	£87323	4899.4	£4365636	14.5	865.9	75.0
GKN	£81000	1794.1	£1534221	14.9	491.7	47.7
Lloyds Banking Group	£79344	3141.6	£2572000	13.6	487.2	75.0
Reed Elsevier	£75209	2596.6	£2028108	13.3	834.7	38.4

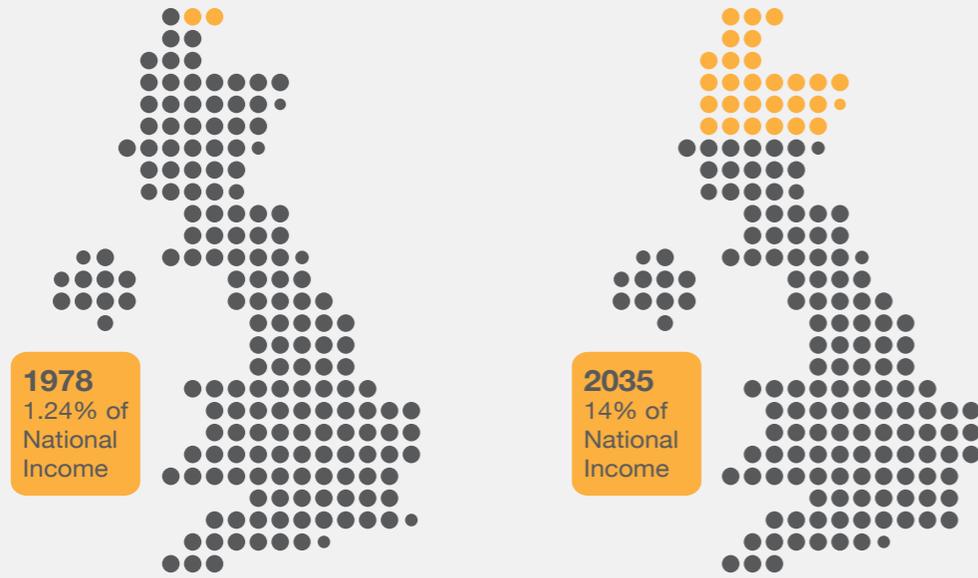
**Why does fair pay matter to companies, the economy and society?** In the interim report we identified the broader impacts of high levels of pay inequality on society, businesses and the economy. In this final report we want to look at these more closely.

<sup>23</sup> F Alvarado et al. (n. d.) The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>.

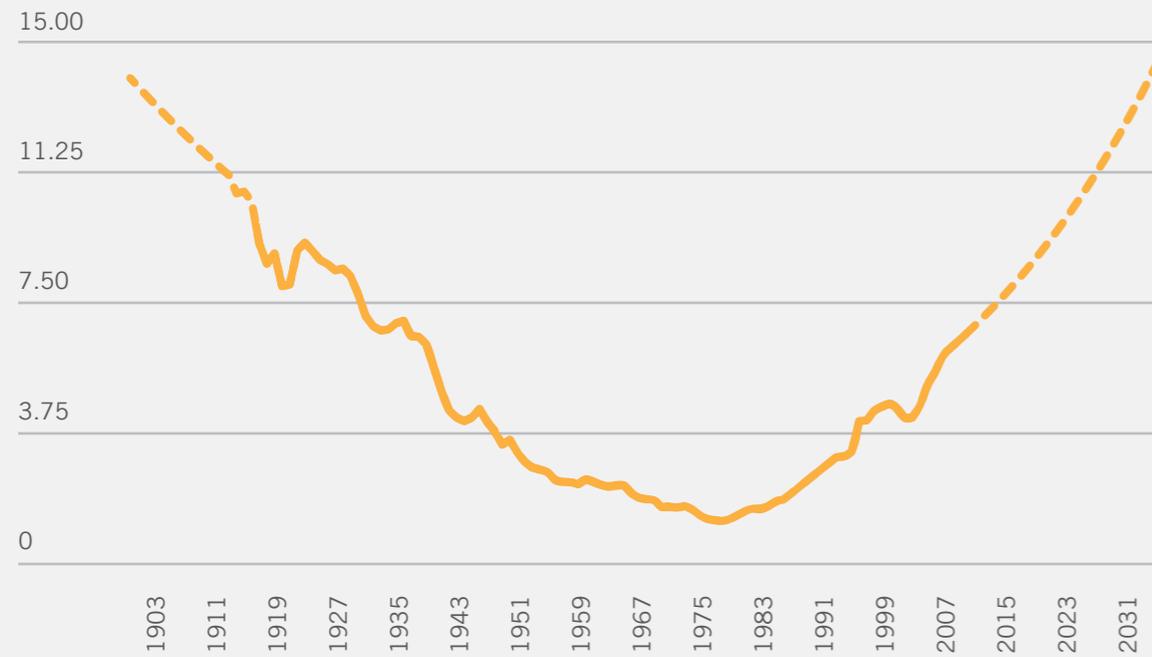
<sup>24</sup> IDS (2010) Directors Pay Report

<sup>25</sup> Data provided by Incomes Data Services. See Annex 3 for information on necessary caveats.

**BY 2035 THE TOP 0.1% WILL TAKE HOME 14% OF THE NATIONAL INCOME. EQUIVALENT TO THAT SEEN IN VICTORIAN ENGLAND.**

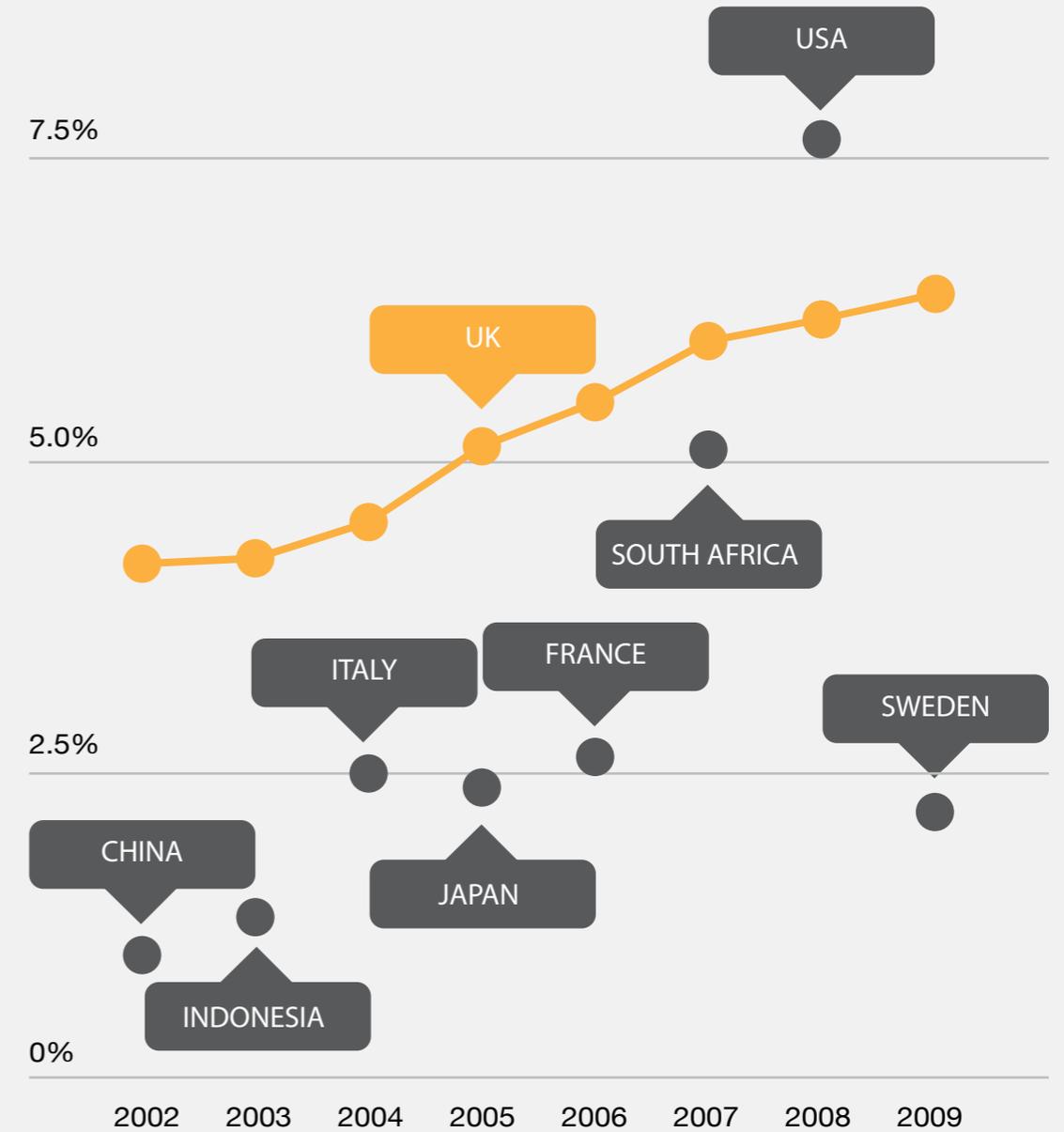


**TOP 0.1% SHARE OF NATIONAL INCOME IN THE UNITED KINGDOM 1900-2035**



• See Annex 3 for source referencing

**TOP 0.1% SHARE OF NATIONAL INCOME. UNITED KINGDOM AS COMPARED WITH THAT OF OTHER COUNTRIES 2002-2009**



• See Annex 3 for source referencing

## 2.1 The business case for fair pay

<sup>26</sup> ABI Principles of Remuneration (2011) [www.ivis.co.uk/ExecutiveRemuneration.aspx](http://www.ivis.co.uk/ExecutiveRemuneration.aspx).

<sup>27</sup> J. Martin (1981) 'Relative deprivation: a theory of distributive injustice for an era of shrinking resources', in B. M. Staw and L. L. Cummings (eds) *Research in Organizational Behavior* 3, JAI Press, 53–107.

<sup>28</sup> Ibid.; F. Crosby (1984) 'Relative deprivation in organizational settings', in B. M. Staw and L. L. Cummings (eds) *Research in Organizational Behavior* 6, JAI Press, 51–93.

<sup>29</sup> J. Martin, 'Relative deprivation'; J. Martin (1982) 'The fairness of earnings differentials: an experimental study of the perceptions of blue-collar workers', *Journal of Human Resources* 17: 110–22; J. Martin (1986) 'When expectations and justice do not coincide', in H. W. Bierhoff, R. L. Cohen and J. Greenberg (eds) *Justice in Social Relations*, Plenum, 317–35; J. Martin and A. Murray (1983) 'Distributive injustice and unfair exchange', in D. M. Messick and K. S. Cook (eds), *Equity Theory: psychological and sociological perspectives*, Praeger, 169–205; J. Martin et al. (1987) 'Now that I can have it I'm not so sure I want it: the effects of opportunity on aspirations and discontent', in B. A. Gutek and L. Larwood (eds), *Women's Career Development*, Sage, 42–65.

The Financial Reporting Council (FRC) UK Corporate Governance Code states that when setting executive pay the remuneration committee of a company should 'be sensitive to pay and employment conditions elsewhere in the group, particularly when determining annual salary increases'. This is included in the code because of a recognition that pay in companies matters.

Indeed the Association of British Insurers' (ABI's) revised code on pay published in 2011 recognises the significance of large pay awards, stating 'Excessive or undeserved remuneration undermines the efficient operation of the company, adversely affects its reputation and is not aligned with shareholder interests.'<sup>26</sup>

There is a strong case for companies to tackle the growing pay gap to enhance or mitigate:

- employee engagement
- reputational harm
- trust in businesses.

### WHY DOES PAY MATTER WITHIN COMPANIES?

It is classically argued that people's sense of fairness within an organisation is based on whether they believe their pay is fair in relation to similarly paid employees.<sup>27</sup> However, this has been

challenged. Academics Martin and Crosby find that individuals also experience a sense of relative deprivation when they compare their rewards with those received by higher status individuals.<sup>28</sup>

A series of studies show that within an organisation lower strata members compare their rewards not just with those of their peers, but with the rewards received by upper-strata groups, and that where the gap is significant these comparisons result in feelings of injustice.<sup>29</sup> Injustice in turn erodes engagement. In a study of university departments Pfeffer and Langton found that employees were more dissatisfied where there was greater salary dispersion, even when pay was related to inputs such as productivity and experience.<sup>30</sup>

Companies are not simply places where goods and services are produced; they are also hotbeds of social comparison. It is for this reason that the quality of what is produced, the service provided and ultimately the success of the business is determined not simply by the best chief executive officer (CEO) but by the motivation of employees. Motivation it is argued is affected by social comparisons, including those with executives who receive far greater rewards in exchange for their contributions.<sup>31</sup>

Within-firm pay inequality is associated with lower-firm performance.<sup>32</sup>

Research suggests that pay equity will influence aspects of lower-level employee motivation – commitment to management goals, effort and cooperation:

- Lower-echelon employees who feel disadvantaged are less supportive of the goals of the over-rewarded group.<sup>33</sup>
- Individuals who believe they are treated fairly have a stronger identification with their company, so they internalise the goals promoted by managers.<sup>34</sup>
- A sense of injustice creates interpersonal resentment, which weakens affiliated emotional bonds between organisation members and thus reduces their willingness to cooperate.<sup>35</sup>

It is commonly recognised that employee engagement remains one of the most significant determining factors in business success (see box 1). In a survey of executives globally, 84% of respondents said that 'disengaged employees' are one of the three biggest threats facing their business.<sup>36</sup>

Employee engagement is affected by several factors, including working conditions, opportunity, management and pay. Fair pay within a company is an important plank in creating an environment where employee engagement can thrive.<sup>37</sup>

<sup>34</sup> C. O'Reilly and J. Chatman (1986) 'Organizational commitment and psychological attachment: the effects of compliance, identification and internalization on prosocial behavior', *Journal of Applied Psychology* 71: 492–99.

<sup>35</sup> D. I. Levine (1991) 'Cohesiveness, productivity, and wage dispersion', *Journal of Economic Behavior and Organization* 15: 237–55; M. Deutsch (1985) *Distributive Justice*, Yale University Press.

<sup>30</sup> J. Pfeffer and N. Langton (1991) 'Wage dispersion, satisfaction, and performance: evidence from college administrators', unpublished manuscript, Graduate School of Business, Stanford University.

<sup>31</sup> D. Cowherd and D. Levine (1992) 'Product quality and pay equity between lower-level employees and top management: an investigation of distributive justice theory', *Administrative Science Quarterly* 37(2): 302–20.

<sup>32</sup> P. Martins (2008) 'Dispersion in wage premiums and firm performance', *Economics Letters* 101: 63–65.

<sup>33</sup> E. Hatfield and S. Sprecher (1984) 'Equity theory and behavior in organizations', in S. B. Bacharach and E. J. Lawler (eds), *Research in the Sociology of Organizations* 3, JAI Press, 95–124.

<sup>36</sup> Economist Intelligence Unit (2010) *Re-engaging With Engagement: views from the boardroom on employee engagement*, [www.businessresearch.eiu.com/sites/businessresearch.eiu.com/files/LON%20-%20PL%20-%20Hay%20report\\_WEB.pdf](http://www.businessresearch.eiu.com/sites/businessresearch.eiu.com/files/LON%20-%20PL%20-%20Hay%20report_WEB.pdf).

<sup>37</sup> Cowherd and Levine, 'Product quality and pay equity between lower-level employees and top management'; M. Bloom (1999) 'The performance effects of pay dispersion on individuals and organizations', *Academy of Management Journal* 42(1): 25–40; J. Shaw, N. Gupta and J. Delery (2002) 'Pay dispersion and workforce performance: moderating effects of incentives and interdependence', *Strategic Management Journal*, 23(2): 491–512; Martins, 'Dispersion in wage premiums and firm performance'.

**BOX 1 THE IMPORTANCE OF EMPLOYEE ENGAGEMENT<sup>38</sup>****Business growth:**

- Towers Perrin-ISR found a gap of **52%** between companies with highly engaged employees and companies whose employees had low engagement scores in the improvement in operating income over the year.<sup>39</sup>
- A Gallup study showed that growth rates for businesses with high-engagement workforces were 2.6 times those for low-engagement businesses.<sup>40</sup>
- Additionally a separate Gallup study showed those with engagement scores in the top quartile averaged **12%** higher customer advocacy and **18%** higher productivity.<sup>41</sup>

**Business success:**

- A Watson Wyatt study of 115 companies suggested that a company with highly engaged employees achieves a financial performance four times greater than companies with poor engagement. It also reported in 2008/9 that the highly engaged are more than twice as likely to be top performers – almost **60%** of them exceed or far exceed expectations for performance.<sup>42</sup>
- In a report for the Institute for Employment Studies, Barber, Hayday and Bevan concluded that a **1%** increase in employee commitment (using a five point scale) can lead to a monthly increase of **9%** in sales.<sup>43</sup>
- A Gallup study showed that companies with engagement scores in the top quartile averaged **12%** higher profitability.<sup>44</sup>

**Accidents:**

- A study by Gallup showed companies with engagement scores in the bottom quartile averaged **62%** more accidents than those in the top quartile.<sup>45</sup>

**Staff turnover:**

- The Corporate Leadership Council in 2008 reported that high-engagement organisations can reduce staff turnover by up to **87%**.
- A Gallup study showed that those with engagement scores in the bottom quartile averaged **31–51%** more employee turnover.<sup>46</sup>

**Staff sickness absence:**

- Engaged employees in the UK take an average of 2.69 sick days per year; the disengaged take 6.19.<sup>47</sup> The CBI reports that sickness absence costs the UK economy **£13.4 billion** a year.<sup>48</sup>

<sup>38</sup> Based on the finding of David Macleod and Nita Clark. See D. Macleod and N. Clarke (2009) Engaging for Success: enhancing performance through employee engagement, Department for Business Innovation and Skills, [www.bis.gov.uk/files/file52215.pdf](http://www.bis.gov.uk/files/file52215.pdf). These points were also raised in W. Hutton (2011) Hutton Review of Fair Pay, HM Treasury, [www.hm-treasury.gov.uk/d/hutton\\_fairpay\\_review.pdf](http://www.hm-treasury.gov.uk/d/hutton_fairpay_review.pdf).

<sup>39</sup> Towers Perrin-ISR (2006) The ISR Employee Engagement Report.

<sup>40</sup> Gallup Organisation (2006) 'Engagement predicts earnings per share'. Referenced in Macleod and Clarke, Engaging for Success.

<sup>41</sup> J. K. Harter et al. (2006) Gallup Q12 Meta-Analysis.

<sup>42</sup> Watson Wyatt (2008) Continuous Engagement: the key to unlocking the value of your people during tough times, WorkEurope survey report 2008–2009, <http://www.watsonwyatt.com/research/pdfs/2008-EU-0617.pdf>.

<sup>43</sup> L. Barber, S. Hayday and S. Bevan (1999) From People to Profits, Institute for Employment Studies.

<sup>44</sup> J. K. Harter et al., Gallup Q12 Meta-Analysis.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

<sup>47</sup> Gallup report in 2003, cited in Melcrum (2005) Employee Engagement: how to build a high performance workforce.

<sup>48</sup> CBI-AXA (2007) Annual Absence and Labour Turnover Survey.

**TRUST IN BUSINESS**

*Trust in business has clearly eroded and needs to be reconstructed. It's very dangerous if a country doesn't trust the private sector*

Andrew Witty, CEO of GlaxoSmithKline<sup>49</sup>

As well as motivated and engaged staff, successful businesses rely on a supportive public. It is therefore concerning that levels of trust in business are so low (see box 2). While some academics specialising in corporate ethics have gone so far as to describe the role that compensation plays in damaging public trust in corporations as 'central', it is fair to describe it as a contributing factor.

When executive rewards seem to go beyond what is linked to their contribution to the success or welfare of the company, it damages public trust and contributes to an attitude that business leaders are 'in it for themselves'.<sup>50</sup>

Indeed this feeling is only exacerbated when a 50% pay rise is proposed for a high-profile business leader such as Sir Martin Sorrell, chief executive and founder of media giant WPP, who had previously stated that 'inequality, the concentration of wealth is a serious issue'.<sup>51</sup> The proposed award would increase his salary from £1m to £1.5m at a time of recession. To the public this reinforces a view of 'them and us' – that business leaders are prepared to say one thing and do another. It creates a

perception of arrogance – that too many corporate leaders have crossed into the first class lounge and are therefore entitled to ever higher rewards for the same or lower effort.

For businesses there is no quick fix. Trust takes time to build, and is easily damaged.

Taking the lead on resolving the current escalation in executive pay is one way to begin to rebuild trust. Indeed as Richard Edelman, CEO of the World Trust Barometer, writing in the Financial Times stated that in order to restore trust:

*CEOs must demonstrate that they too feel the burden of the recession. At a time when many people are losing jobs and investors are seeing stock values plummet, voluntary executive pay cuts and forfeiting of bonuses send a powerful message that leaders are in tune with the realities facing employees.*<sup>52</sup>

<sup>49</sup> Andrew Witty in an interview for the High Pay Commission

<sup>50</sup> R. Thompson (2009) 'Excessive executive pay – what's the solution?', Harvard Business School; K O'Hanson, 'Public trust in business', Santa Clara University.

<sup>51</sup> P. Aldrick (2011) 'Davos WEF 2011: wealth inequality is the "most serious challenge for the world"', Telegraph, [www.telegraph.co.uk/finance/financetopics/davos/8283310/Davos-WEF-2011-Wealth-inequality-is-the-most-serious-challenge-for-the-world.html](http://www.telegraph.co.uk/finance/financetopics/davos/8283310/Davos-WEF-2011-Wealth-inequality-is-the-most-serious-challenge-for-the-world.html).

<sup>52</sup> R. Eldeman (2009) 'Restoring trust in business', Financial Times, 27 January, [www.ft.com/cms/s/0/6a632aa2-ebdb-11dd-8838-0000779fd2ac.html#ixzz1XMwuOTw8](http://www.ft.com/cms/s/0/6a632aa2-ebdb-11dd-8838-0000779fd2ac.html#ixzz1XMwuOTw8).

This decline in trust is set against a backdrop of a renewed public demand for accountability among business leaders (see box 2). Whether this is politicians or bosses there are new expectations on those who lead.

### BOX 2 TRUST IN BUSINESS

According to the Edelman Trust Barometer:

- In the UK only one-third of the public trust company executives.
- The credibility of the CEO as a ‘trusted spokesperson’ is at an all-time low of **29%** globally and **20%** in the UK.
- Trust in businesses to do the right thing fell in the UK by **5%** between 2009 and 2010 to **44%**
- The public expects companies to behave in the interests of society: **89%** of respondents agreed that corporations should create shareholder value in a way that aligns with society’s interests, even if that means sacrificing shareholder value.
- There is further support for government intervention with **82%** agreeing that government should regulate corporations’ activities to ensure businesses behave responsibly.
- Whether the public trusts a company is now as important to the public as the products it produces.

### REPUTATIONAL HARM

The growing public and press interest in the issue of executive pay increases the likelihood of reputational harm. Business leaders risk damaging their reputations and those of their companies as public anger grows over the size of executive pay packages.

It is widely recognised that damage to reputation will ultimately hurt profit margins, and can lead to public protests, like those carried out by UK Uncut against the Top Shop boss Sir Philip Green’s alleged tax avoidance.

This is exacerbated in times of austerity, but fear of reputational harm, even in good times, appears to have led to attempts to ‘camouflage’ executive pay. Ever more complicated pay arrangements, hidden within reams of remuneration reports, appear designed to obfuscate as much as they reveal.<sup>53</sup>

This lack of clarity, encouraged in part by a fear of reputational harm, leads to a decline in transparency, not just from the public but also from the owners of the business, the shareholders, who struggle to determine what level of reward is being given for what level of performance. This is inefficient and further encourages the sense of public distrust when the actual levels are disclosed in the press.

## 2.2 The economic case for fair pay

Min Zhu, a special adviser at the International Monetary Fund and a former deputy governor of the People’s Bank of China, told delegates at Davos:

*Increasing inequality is the biggest challenge the economy faces for the whole world – not just advanced economies... We cannot let the income disparities increase further... I don’t think the world is paying enough attention.*

The economic case for getting to grips with the dramatic escalation in top pay is increasingly apparent. Extreme levels of pay inequality have an impact on:

- entrepreneurialism
- growth
- economic instability
- sectoral imbalances
- social mobility.

### ENTREPRENEURIALISM

Small businesses, new businesses and innovation are essential to the UK economy. Small businesses employing

less than 50 people account for 46% of all private sector workers.<sup>54</sup> Yet it has been argued that the growth in pay at the top is discouraging entrepreneurialism.<sup>55</sup> Indeed it makes sense to avoid taking the risk: why risk your own capital, your family home, when the opportunity for independent wealth awaits the company man or the banker?

### BOX 3 THE ENTREPRENEUR

- Levels of entrepreneurialism in the UK have been increasing in recent years as a result of increased government focus. However, only 6.3% of the working population are involved in entrepreneurial activities. This figure is lower than comparable figures in the Netherlands, Norway and the USA but higher than those in Spain and Italy.<sup>56</sup>
- Entrepreneurs are essential to economic growth. A recent OECD paper stated, ‘It is abundantly clear that entrepreneurship is important for economic growth, productivity, innovation and employment.’<sup>57</sup>
- Studies have shown there is a relationship between patents per head of population and equality, suggesting that entrepreneurship and innovation may be higher in more equal countries.<sup>58</sup>
- Entrepreneurialism is a high-risk activity, with the average personal investment in a business standing at £7,000. This risk does not go away; indeed it is often exacerbated as a start-up grows with individuals mortgaging assets.

<sup>54</sup> Department for Business, Innovation and Skills (2010) Business Population Estimates for the UK and Regions.

<sup>55</sup> D. Bolchover (2010) Pay Check; F. Salmon (2011) ‘Norway, entrepreneurial paradise’, F Salmon, ‘Norway, entrepreneurial paradise’, blog, 20 January, <http://blogs.reuters.com/felix-salmon/2011/01/20/norway-entrepreneurial-paradise/>.

<sup>56</sup> International Entrepreneurship, [www.international-entrepreneurship.com/](http://www.international-entrepreneurship.com/).

<sup>57</sup> OECD (2009) The Importance of Entrepreneurship, Organisation for Economic Co-operation and Development.

<sup>58</sup> Wilkinson and Pickett, The Spirit Level.

## THE PROBLEMS WITH GROWTH

*This inequality is destabilizing and undermines the ability of the economy to grow sustainably and efficiently... [Income inequality] is anathema to the social progress that is part and parcel of such growth.*

Sarah Bloom Raskin,  
Board of Governors of the Federal Reserve System

It has traditionally been argued that inequality is actively good for growth. An environment where people are able to do very well is good for aspiration, driving the workforce to compete, and indeed higher earners save more and so are more likely to invest.

However, this classic post-Keynesian model is increasingly being challenged in light of a growing body of evidence which suggests that gross inequality in income contributes to sectoral imbalances, regional disparities in investment and asset bubble inflation. It has been argued that this growth in inequality results in higher levels of investment in assets. This investment in assets can encourage economic instability and increase the likelihood of shocks and financial crises.<sup>59</sup>

In the current economic environment, pay becomes ever more important and it is argued that extremes in income distribution are hampering our ability to grow out of the crisis for the reasons cited above.<sup>60</sup> High pay, wage inequality and the suppression of wages for the majority is of course not the only explanation for the above economic events, but it is a part of the puzzle.

It is increasingly recognised that income and wealth inequality is having a profound effect on our economy. As economist Mark Thoma, of University of Oregon put it:

*There is an equivalent of a Laffer curve for inequality, but the variable of interest is economic growth rather than tax revenue. We know that a society with perfect equality does not grow at the fastest possible rate. When everyone gets an equal share of income, people lose the incentive to try and get ahead of others. We also know that a society where one person has almost everything while everyone else struggles to survive – the most unequal distribution of income imaginable – will not grow at the fastest possible rate either. Thus, the growth-maximizing level of inequality must lie somewhere between these two extremes.<sup>61</sup>*

Indeed, the former chief economist at the IMF, Raghuram Rajan, has argued that high levels of inequality contributed to the financial crisis. Rajan, in his recent book *Fault Lines*, demonstrates that high levels of wage inflation at the top and wage stagnation for the rest of the population led to a growth in easy credit. As the rich got richer and average wages stagnated governments could not simply stand by as the poor and unskilled fell farther behind.<sup>62</sup>

Roland Benabou, professor of economics at Princeton University, further argues that high levels of inequality do not lead to more efficient investments. The reason for this is the existence of incomplete asset markets and liquidity constraints, which suggest that a reduction in inequality may lead the poor to carry out more efficient investments.<sup>63</sup>

Thus, the allocation of investment may be more efficient under greater equality. Those on lower incomes will be more likely to spend an important

fraction of additional wealth in health and education-enhancing spending; it may effectively contribute more than a rich family's savings to capital accumulation.<sup>64</sup>

Rajan also argues that in unequal societies the rich spend significant amounts trying to shape 'rules of the game' in their favour.<sup>65</sup>

Further work from academic Dani Rodrik has provided empirical evidence that unequal societies are less likely to carry out the adjustments necessary to respond to negative macroeconomic shocks.<sup>66</sup>

This is supported by academics Alesina and Drazen, who demonstrate that inequality can be harmful to long run economic growth, making economic reforms less likely. They argue that inequality can reduce the base of support for fundamental structural transformations necessary to embark on a path of high growth.<sup>67</sup>

<sup>59</sup> A. Alesina and D. Rodrik (1994) 'Distributive politics and economic growth', Quarterly Journal of Economics 109(2): 465–90; T. Persson and G. Tabellini (1994) 'Is inequality harmful for growth?', American Economic Review 84(3): 600–21; K. Forbes (2000) 'A reassessment of the relationship between inequality and growth', American Economic Review 90(4): 869–87; R. Barro (2000) 'Inequality and growth in a panel of countries', Journal of Economic Growth 5(1): 5–32; A. Banerjee and E. Duflo (2003) 'Inequality and growth: what can the data say?', Journal of Economic Growth 8(3): 267–99.  
<sup>60</sup> In stating that an economic model based on growth is desirable the commission recognises the current debate on whether growth is sustainable, and on whether an alternative paradigm is now necessary.

<sup>61</sup> Quoted in J. Fox (2011) 'Why business is stuck on income inequality', Harvard Business Review blog, <http://blogs.hbr.org/fox/2011/01/can-and-will-business-do-anymth.html>.  
<sup>62</sup> R. Rajan (2010) *Fault Lines*.  
<sup>63</sup> R. Benabou (1996) 'Inequality and growth', in B. Bernanke and J. Rotemberg (eds) (1996) *NBER Macroeconomics Annual 1996*, MIT Press. <sup>64</sup> N. G. Mankiw, D. Romer and D. Weil (1992) 'A contribution to the empirics of economic growth', Quarterly Journal of Economics, May.  
<sup>65</sup> Rajan, *Fault Lines*.  
<sup>66</sup> D. Rodrik (1998) 'Where did all the growth go? External shocks, growth collapses and social conflict', NBER Working paper 6350.  
<sup>67</sup> A. Alesina and A. Drazen (1991) 'Why are stabilizations delayed?', American Economic Review 81(5).

**BOX 4 A BRIEF HISTORY OF PAY IN FINANCE**

Up until the 1930s and after the 1980s jobs in financial intermediation were relatively skill intensive, complex and highly paid, but this was notably not the case in the interim period.<sup>69</sup>

From 1909 to 1933 the financial sector was a high wage industry. During the 1930s a dramatic shift occurred and the financial sector lost much of its wage premium relative to the rest of the economy. This dramatic drop was followed by a more moderate decline from 1950 to 1980. Indeed by the 1980s wages in the financial sector were similar, on average, to wages in the rest of the economy.

However, during the stock market ‘big bang’ in the 1980s there was a rapid shift and the financial sector became once again a high skill, high wage industry. It is notable that relative wages in finance had returned to the levels of the 1930s by 2006.<sup>70</sup>

<sup>68</sup> W. Hutton (2010) Hutton Review of Fair Pay in the Public Sector: interim report.

<sup>69</sup> T Philippon and A. Reshef (2008) Wages and Human Capital in the U.S. Financial Industry: 1909–2006.

<sup>70</sup> Ibid.

<sup>71</sup> J. Bladen (2005) ‘Social mobility in Britain: low and falling’, CentrePiece, spring, <http://cep.lse.ac.uk/centrepiece/v10i1/bladen.pdf>; J. Bladen et al. (2001) ‘Changes in intergenerational mobility in Britain’, CMPO working paper, [www.bristol.ac.uk/cmppo/research/families/socialmobility.html](http://www.bristol.ac.uk/cmppo/research/families/socialmobility.html); HM Government (2010) Opening Doors, Breaking Barriers: a strategy for social mobility (2010) <http://download.cabinetoffice.gov.uk/social-mobility/opening-doors-breaking-barriers.pdf>.

<sup>72</sup> J. Bladen, P. Gregg and S. Machin (2005) Intergenerational Mobility in Europe and North America, London Centre for Economic Performance, London School of Economics.

<sup>73</sup> Wilkinson and Pickett, The Spirit Level.

<sup>74</sup> World Bank (2006) World Development Report 2006: equity and development, Oxford University Press; K. M. Murphy, A. Shleifer and R. W. Vishny (1991) ‘The allocation of talent: implications for growth’, Quarterly Journal of Economics 106(2).

**SECTORAL IMBALANCE**

There are further concerns that high levels of income inequality are resulting in sectoral imbalance. Between 1998 and 2007, 60% of the rise in the overall income share of the top 10% went to finance workers. It is therefore not surprising that many talented individuals choose to make their career in the City.<sup>68</sup>

The impact of this on the economy as a whole is not yet known but Andrew Witty, CEO of GSK, discussing the financial sector stated: ‘It drew out a huge amount of talented graduates.’ This impacts on our economy. If levels of pay in one sector disproportionately attract talent, this affects our economy as a whole by withdrawing the talent required for engineering, teaching, medicine, manufacturing and other wealth-generating and socially important industries.

High pay in the financial sector has had the effect of recruiting to a life of financial intermediation many who would otherwise have gone into other careers.

**SOCIAL MOBILITY**

Social mobility has always been high up the political agenda, it is important for our economy to have the most able people in the right jobs.

In the UK over the last 30 years, despite political attention on equality of opportunity, we have seen social mobility decline.<sup>71</sup> Both intra and intergenerational mobility appear to be affected by inequality. Intergenerational mobility has been declining in Britain over the same period as the gap between the top and the bottom has widened.<sup>72</sup> Further countries with higher levels of inequality also have lower levels of social mobility.<sup>73</sup>

As the World Bank argued in its *World Development Report 2006*, poor social mobility will thus be harmful to long-run economic growth, leading the Bank to advise that ‘in the long run, equity [of opportunity] and efficiency may be complements, not substitutes’.<sup>74</sup>

## 2.3 The social case for fair pay

Discussion on the social impacts of pay inequality has traditionally focused on the impact of poverty. How wage disparities create poverty traps and intergenerational unemployment. How poverty and deprivation, even in a wealthy country such as the UK, still affect morbidity and mortality rates. How poverty ruins life chances. Yet this is only half the story. As it is not just pay at the bottom that matters, but pay at the top too.

Social comparisons do not just take place within companies; they occur across society. However, when the gap between the haves and everyone else becomes so large it does not encourage aspiration or cohesion but disengagement and social unrest we have reached a tipping point.

The riots that started in London and spread across the country in the summer of 2011 will over the years be much examined and the causes much explored. But it should not perhaps surprise us that the rioters took the trappings of wealth that they could not afford – the TVs and designer trainers. It reflects a sense of entitlement that pervades society from the very top to the bottom.

Inequality does not come without economic and social consequences.<sup>75</sup> The growing gap between the top strata of society and the rest of the population has specific effects, which it is relevant to discuss here.

**INEQUALITY AND INSTABILITY**

Nouriel Roubini, professor of economics at New York University, warned that inequality ‘exacerbates political instability’.<sup>76</sup>

It has been argued that inequality can lead poorer groups to pursue their economic objectives outside the mainstream. This can lead to higher levels of participation in violent political movements, and social unrest.<sup>77</sup>

A report from the United Nations states, ‘High levels of inequality can lead to negative social, economic and political consequences that have a destabilising effect on societies.’<sup>78</sup> As social mobility recedes so does opportunity. If opportunity is extinguished, unrest will surely follow. This, it is clear, is the lesson of history.<sup>79</sup>

**INEQUALITY AND INFLUENCE**

The size of reward metered out to ‘spivs and gamblers’<sup>80</sup> in the banking system not only represents but exacerbates a ‘take what you can get’ culture. As the Archbishop of Canterbury has argued recently: ‘Economic exchange is one of the things people do. Treat it as the only ‘real’ thing people do and you face the same problems that face the evolutionary biologist for whom the only question is how organisms compete and survive, or the fundamentalist Freudian for whom the only issue is how we resolve the tensions of infantile sexuality.’<sup>81</sup>

<sup>75</sup> The discussion on the social impact is stated in brief here. In doing so we recognise there is a much broader discussion. See Danny Dorling (2011) Bankrupt Britain: an atlas of social change, Policy Press; Stewart Lansley (2011) ‘The limits to inequality: the crisis and the widening income divide’, Policy Network, [www.policy-network.net/articles/4061/The-Limits-to-inequality-the-crisis-and-the-widening-income-divide](http://www.policy-network.net/articles/4061/The-Limits-to-inequality-the-crisis-and-the-widening-income-divide); and Wilkinson and Pickett, The Spirit Level.

<sup>76</sup> N. Roubini (2011) Global Economic Insecurity and Inequality Breeds Social and Political Instability.

<sup>77</sup> Ibid.

<sup>78</sup> United Nations (2008) State of the World’s Cities.

<sup>79</sup> Dhaval Joshi of BCA Research.

It is also no surprise that economic power tends to beget political power. In developed democratic nations like the UK, this tends to work through contributions to political parties and access to politicians that wealth and money can buy. This power can in turn be used to exert bias that favours unreasonably or unfairly the status quo – or vested interests.<sup>82</sup>

This in turn creates backlashes in public attitudes, which Prime Minister David Cameron identified:

*I believe that secret corporate lobbying, like the expenses scandal, goes to the heart of why people are so fed up with politics. It arouses people's worst fears and suspicions about how our political system works, with money buying power, power fishing for money and a cosy club at the top making decisions in their own interest. We can't go on like this. I believe it's time we shone the light of transparency on lobbying in our country and forced our politics to come clean about who is buying power and influence.<sup>83</sup>*

Fair pay in companies does not take place in isolation. Paying fair at the top is not just about what is good for companies; it is also about ensuring that the very people who can benefit the most are not able to exert excessive influence in their own interest.

<sup>80</sup> Vince Cable (2010) speech made at Liberal Democrat Conference 2010.

<sup>81</sup> R. Williams and L. Elliott (2010) Crisis and Recovery: ethics, economics and justice, Palgrave Macmillan, 21.

<sup>82</sup> D. Acemoglu (2011) 'Economic power begets political power', The Economist, [www.economist.com/economics/by-invitation/guest-contributions/economic\\_power\\_begets\\_political\\_power](http://www.economist.com/economics/by-invitation/guest-contributions/economic_power_begets_political_power).

<sup>83</sup> D. Cameron (2010) 'Rebuilding trust in politics', speech, [www.conservatives.com/News/Speeches/2010/02/David\\_Cameron\\_Rebuilding\\_trust\\_in\\_politics.aspx/](http://www.conservatives.com/News/Speeches/2010/02/David_Cameron_Rebuilding_trust_in_politics.aspx/)

## ATTITUDES TO HIGH PAY

How much do you agree or disagree that ... ordinary working people do not get their fair share of the nation's wealth.



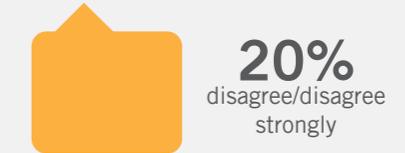
How much do you agree or disagree that ... management will always try to get the better of employees if it gets the chance.



How much do you agree or disagree that ... Differences in income in Britain are too large.



How much do you agree or disagree that ... It is the responsibility of the government to reduce the differences in income between people with high incomes and those with low incomes



How much do you agree or disagree that ... big business benefits owners at the expense of workers.



How much do you agree or disagree that ... ordinary working people do not get their fair share of the nation's wealth.



• See Annex 3 for source referencing

# 3 | How do we reform pay at the top?

## Where now?

As this report has shown, there has been a dramatic escalation in top pay over the last 30 years. This growth has taken place primarily in the private sector; it is our business leaders and bankers who are taking a bigger slice of the pie even as average wages across the private sector have stagnated.

We are now at a tipping point where company reputations hang in the balance and our economy will not be helped by allowing this to persist. 'Where now?' is perhaps the most important question for us all to address.

This seemingly simple question raises a myriad of issues, problems and pitfalls. It forces us to address not just what is too much but what is fair and in the long term interests of our businesses and our society. One report, one commission for one year cannot hope to resolve all of these. Ultimately it must be a process, taking place over the longer term in which business, politicians and the public engage.

However, through this investigation into high pay it has become evidently clear that the starting point should be based on the key principles of transparency, accountability and fairness.

These key principles, which are interlinked and inseparable, have each been missing, undermined or ignored for too long when it comes to pay at the top. Yet key reforms to the way companies behave and are regulated could mark an important turning point.

In the following section we put forward why these key principles are important, and why and how they are currently missing, and propose reforms that would begin to redress this.

However, we must also recognise that there is no quick fix. It took 30 years to get us to this place and it may easily take that long to reverse. This is not to admit defeat, but is a recognition that these are just the first steps in what is the much longer and deeper process of cultural and economic change that is required.

In recognising this, the Commission has sought to put forward policies that can represent these first important steps, focusing on returning the three key principles to pay setting which have been missing for too long at the top. These principles relate to pay but they are part of a wider debate about not just what fair pay is, but what is pay in the context of the good economy?

## 3.1 Transparency

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*Sunshine is the best disinfectant.*

David Cameron, Prime Minister

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A growing focus over the last decade on poverty and pay at the bottom of the income spectrum, including the establishment of the Low Pay Commission, has increased public awareness and ensured we know more about what has happened to those at the bottom – but what has taken place at the top of the income distribution has remained largely a mystery.

The original remit of the High Pay Commission was to find out what had happened to pay at the top of the income spectrum, and we have been deeply concerned at the lack of available information.

Further the Commission is concerned at the level of public understanding on what has happened at the top of the pay distribution. Most people think that the public sector is better rewarded than the private sector and the people who know how well rewarded those at the top of our companies are, are few and far between.<sup>84</sup> This further contributes to a culture of mistrust and public outrage when the truth becomes apparent – as it invariably seems to.

The government has identified the importance of transparency for restoring trust in government and the public sector. It is right to recognise that transparency

<sup>84</sup> Hutton, Hutton Review of Fair Pay.

**BOX 5 EXECUTIVE PAY FOR PERFORMANCE<sup>87</sup>**

Key points include:

- For on-target performance FTSE 100 lead executives received a bonus worth **48%** of salary at the median in 2002.
- For the same level of performance in 2010, a FTSE 100 lead executive bonus was worth **90%** of salary at the median.
- In 2002, the median bonus for maximum performance for a FTSE 100 lead executive equalled **75%** of salary.
- By 2010, maximum performance for a FTSE 100 lead executive commanded a bonus worth **150%** of salary at the median.
- Although less spectacular, similar increases in bonus thresholds took place for other FTSE 350 directors.
- In 2002, the median maximum grant of shares that a FTSE 100 lead executive could be awarded was **100%** of salary.
- By 2010, the median maximum LTIP (Long Term Incentive Plan) grant for a FTSE 100 lead executive had risen to **200%** of salary.

However, the extent to which this has been successful is contested and performance-related pay has gone on to undermine transparency as well as function as a major driver of the growth of executive pay.<sup>85</sup>

**UNDERSTANDING PAY FOR PERFORMANCE**

It is commonly argued that variable pay and bonuses can effectively be used to encourage individuals to behave in certain ways. Across the private sector we have seen a boom in performance-related pay, and indeed this principle is now being encouraged in the public sector. The principle has been pushed to its extremes for those at the very top of the pay spectrum in finance and other companies, and is one of the key drivers of the escalation in top pay.

A focus on new and innovative forms of compensation, designed to align interests and link pay to performance, has accompanied an increase in the aggregate amount of the awards. For executives this increase in performance-related pay has resulted in a dramatic escalation in the quantum received (see box 5). Both the on-target and maximum levels for performance-based rewards have increased so that what passed as the maximum bonus in 2002 is lower than what a director would receive today for on-target performance.<sup>86</sup>

is essential for public trust and indeed the same can be true of the private sector – with greater transparency companies can begin to encourage greater public trust.

When it comes to pay in the corporate world, transparency has been undermined by the ever increasing complexity in the rewards that have been constructed for top executives. This level of complexity was introduced through ‘innovation’ in top pay designed to bring the interests of the executive in line with those of the shareholder.

Indeed not only has the value of awards increased, but also the numbers of directors receiving them. At the height of the crisis in 2009 83% of directors still received their annual bonus; indeed this increased in 2010 to 95%. It seems beyond belief that 95% of all lead executives in the FTSE 350 performed so well they earned an annual bonus, particularly when we consider that across the FTSE 350 performance indicators improved only marginally.<sup>88</sup>

Executive pay packets now include a significant performance-related element: the average top award that could be achieved under all share-based incentive schemes in the FTSE 100 was 328% of salary in 2010.<sup>89</sup> This performance part of the total award is made up of a number of elements (see box 6) tied to individual personal targets and company performance.

This has contributed to increasing complexity in pay packages. Indeed it has now resulted in a situation where only relatively few individuals with technical insight are able to understand what an executive is being paid – indeed even when attempts are made to calculate the total pay package, these are often challenged by the company. Thus despite legislation designed to increase transparency in relation to executive pay, the issue remains murky to say the least.

**WHY HAS PERFORMANCE-RELATED PAY BEEN USED?**

The current view on performance-related pay for executives can be traced back to 1979 with an incoming Conservative government and a new attitude to top pay.<sup>90</sup> The government believed UK businesses would be more successful in future if quasi-entrepreneurial capitalists at the top of companies were created, linking pay to performance and tying the interests of the executive to those of the shareholder to manage the principal or agent problem.

They aspired to create an entrepreneurial spirit in what was seen as the tired, bureaucratic company man. The government of the time cut top rates of tax and encouraged the use of share-based awards. Share options arrived as the first wave of innovation. This was followed by share option grants, then long-term incentive plans, and more recently a plethora of phantom options, restricted stock awards and matching share awards. It is assumed that what motivates executives most is money, and that the interests of shareholders are best served by appealing to this.

From 1979 we began to witness an increase in executive pay. By the early 1990s this had started to prompt concern from politicians and the general public in light of the growing economic turmoil. In this context and in response to the corporate scandals of Polly Peck and BCCI the Conservative government of the time brought in Lord Cadbury to

<sup>85</sup> For a discussion on why pay for performance has driven the growth in top pay see High Pay Commission, *More for Less*.

<sup>86</sup> Income Data Services (2011) *What Are We Paying For? Exploring executive pay and performance*, High Pay Commission.

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*

<sup>89</sup> High Pay Commission, *More for Less*.

<sup>90</sup> Income Data Services, *What Are We Paying For?*

review corporate governance guidelines. His subsequent report published in 1992 recognised the growth in executive pay and the public's concern, and proposed greater shareholder oversight and an enlarged role for non-executive directors.<sup>91</sup>

In 1995 continuing public concern over executive pay – focused particularly on the pay awards received by those at the top of the newly privatised utilities – prompted the government to bring in Sir Richard Greenbury of Marks & Spencer. Greenbury accepted and built on the principles laid down by Cadbury and emphasised three key themes that shaped future executive compensation practice:

- Link pay to performance.
- Align interests of the executive and shareholders.
- Increase shareholder oversight based on increased disclosure on executive pay.

Despite this innovation in pay structures and numerous attempts to link pay to performance this ideal of creating quasi-entrepreneurs at the top of publicly listed companies has not been achieved for the following reasons:

- Unlike entrepreneurs, executives have no, or relatively little, direct personal financial investment in their jobs. While they may risk losing their job if they perform badly or there is a change in company fortunes, as with every other employee, unlike

the entrepreneur, very little of their personal capital is at risk if they fail. Even when they do lose their jobs they often have generous severance packages.<sup>92</sup>

- The growth in performance-related pay has not come at the expense of basic fixed pay, which has also increased. Over the last ten years there has been a 63.9% increase in executive base pay.<sup>93</sup>
- According to a report conducted by Incomes Data Services for the High Pay Commission nearly all the components of boardroom pay, with the exception of share option gains, increased at a faster rate over the last ten years than corresponding measures of corporate performance.<sup>94</sup>

Rather than link pay to performance, this has only served to increase the total amounts awarded. Between 1949 and 1979 executive pay grew by 0.8% per year on average. Over the last 10 years annual growth in the pay for FTSE 100 executives has been closer to 20%.<sup>95</sup>

In essence, while entrepreneurs usually risk their own capital, boardroom executives, like bankers, risk other people's. The granting of share options and long-term investment plans as a way of giving such executives 'skin in the game' has not really delivered the levels of entrepreneurial zeal the enthusiasts for top pay may have hoped for and expected.

## HAS PAY BEEN LINKED TO PERFORMANCE?

No reputable study has shown that executive pay has been successfully linked to company performance. Indeed the body of evidence challenging the link between pay and performance has become increasingly compelling.

This dislocation between pay and performance has been most pronounced in the last few years of recessions where a spectacular growth in bonus payments over the period has pulled significantly ahead of market capitalisation, earnings per share and pre-tax profit (see box 8).<sup>97</sup>

## BOX 6 REMUNERATION FOR EXECUTIVES

The total remuneration for the executive includes:

- base salary
- benefits
- short-term incentives, such as annual bonuses
- medium-term incentives, such as deferred and matching shares
- long-term incentives consisting of performance shares, share options or both running concurrently
- a self or co-investment plan
- a pension.

## BOX 7 THE PRINCIPAL AGENT PROBLEM

The principal agent problem occupies reams of academic texts, starting with the work of Berle and Mears, 'Separation of ownership and control'.<sup>96</sup>

Essentially it is a recognition that the interests of the agents, the managers of companies, may differ from the now diverse and disparate owners, the shareholders – the principals.

What may be in the managers' interest, such as empire building or vanity projects, may not be in the interests of the shareholders. This is why corporate governance and more recently pay has been used as a method of aligning the interests of the executive and the shareholders.

Aligning interests through pay is seen as the golden bullet of corporate governance. In response, increasingly complex 'innovations' in pay practices have been used to attempt to align interests and motivate those in companies to give the desired performance.

<sup>91</sup> Committee on the Financial Aspects of Corporate Governance (1992) Report with Code of Best Practice, [Cadbury Report], Gee Publishing.

<sup>92</sup> High Pay Commission, More for Less.

<sup>93</sup> Executive pay based on figure from Income Data Services (IDS); average pay based on figures from the Annual Survey of Hours and Earnings.

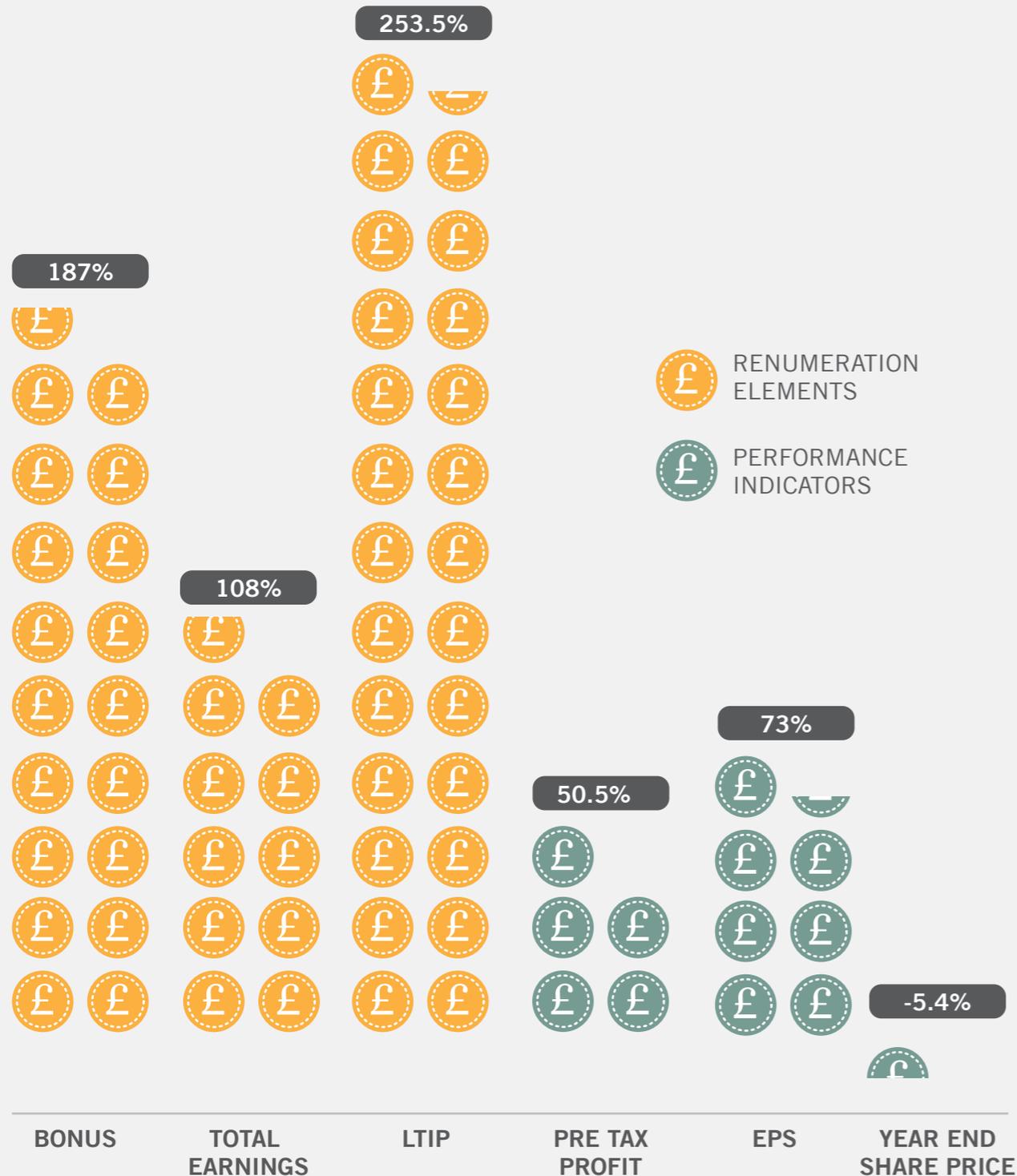
<sup>94</sup> Income Data Services, What Are We Paying For?

<sup>95</sup> C. Frydman and R. Saks (2007) 'Executive compensation: a new view from a long-term perspective 1936-2005', [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=972399](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=972399); High Pay Commission (2011) More For Less

<sup>96</sup> A. A. Berle and G. C. Means ([1932] 1935) The Modern Corporation and Private Property, Macmillan.

<sup>97</sup> Income Data Services, What Are We Paying For?

**WHAT HAS HAPPENED TO AVERAGE PAY OF ALL FTSE 350 DIRECTORS AND AVERAGE CORPORATE PERFORMANCE MEASURES BETWEEN 2000 AND 2010 (%)**



• See Annex 3 for source referencing

**DOES PERFORMANCE RELATED PAY REALLY WORK?**

The question of whether pay for performance works is a controversial one. Popular common sense suggests that people can and will work within a range of effort and through pay we can encourage them to work harder and towards certain defined goals. However, this is increasingly questioned and the interaction between financial incentives and performance is not simple.

While within economics it is accepted that financial incentives motivate individuals, psychologists suggest there is a more problematic relationship. The work of Professor Dan Arieli shows that high reward levels can have detrimental effects on performance.<sup>99</sup> Indeed in all the experiments his team conducted, the highest levels of rewards produced lower performance on all tasks.<sup>100</sup>

Further, McGraw and McCullers demonstrate that the introduction of monetary rewards for tasks that involved problem-solving had detrimental effects on performance. In addition to the narrowing of attention, large incentives can simply occupy the mind and attention of the labourer, distracting the individual from the task at hand.<sup>101</sup>

Work by Benabou and Tirole also supports this; they argue that incentives are only weak reinforcers in the short run, and negative reinforcers in the long run.<sup>102</sup>

**BOX 8 KEY POINTS ON THE LINK BETWEEN EXECUTIVE PAY AND PERFORMANCE<sup>98</sup>**

- Salary growth over the last ten years bears no relation to market capitalisation, earnings per share or pre-tax profit.
- There is no, or little, relation between the total earnings trend and market capitalisation.
- A slightly closer relation seems evident between total earnings, pre-tax profit and earnings per share, but they do not mirror each other exactly and the trend diverges significantly during certain periods.

When it comes to pay at the top, the work of psychologist Frederick Herzberg is particularly relevant. He defined two types of factors that contribute to motivation: one type contributes to job satisfaction and the other only to job dissatisfaction.<sup>103</sup>

Factors contributing to a higher level of satisfaction on the job included achievement and recognition, opportunities for advancement and growth, level of responsibility and the work itself. Reasons for dissatisfaction on the job were relationship with boss, supervision, company policies and work conditions, relationships with peers and salary. Although a low salary results in dissatisfaction among workers, a high salary was not shown to have the same type of positive effect. Performance-related pay is thus a less than effective motivational tool.

When we interviewed CEOs we equally found they have a range of motivations for performance. This is not to say that pay does not matter – but simply that executives are not motivated to perform for purely monetary rewards (see box 9).

<sup>98</sup> Ibid.  
<sup>99</sup> D. Arieli et al. (2009) 'Large stakes and big mistakes', *Review of Economic Studies*, 76(2): 451–69.  
<sup>100</sup> Ibid.  
<sup>101</sup> K. O. McGraw and J. C. McCullers (1979) 'Evidence of a detrimental effect of extrinsic incentives on breaking a mental set', *Journal of Experimental Social Psychology* 15: 285–94.  
<sup>102</sup> R. Benabou and J. Tirole (2003) 'Intrinsic and extrinsic motivation', *Review of Economic Studies* 70(3), 489–520.  
<sup>103</sup> See Businessballs (n. d.) 'Frederick Herzberg motivational theory', [www.businessballs.com/herzberg.htm](http://www.businessballs.com/herzberg.htm).

### BOX 9 ATTITUDES TO REWARDS BASED ON INTERVIEWS CONDUCTED BY THE HIGH PAY COMMISSION

*I've had approaches from the US and if I wanted to maximise my earning potential, I should have taken them, but there's more to life than money. This is my company and having a chance to run it and bring it back to its best is a great privilege.*

Andrew Witty, CEO GSK

*Most people want to do something they are proud of; most people want to create a legacy and leave something behind. There are also a set of broader needs: the younger generation want to see the company is doing something different.*

Ian Cheshire, CEO Kingfisher

*I'm keen to create value for the pension funds that are our owners. I like bringing people on, advancing careers. There are absolutely non-financial reasons why people work, but you can't ignore the financial side.*

A CEO of a UK company

*There are other motivations; it's the chance to be associated with something important and new and it's about change management. I get a rush out of coming and changing something for the better, it gives a value.*

Tim O'Toole, CEO First Group

<sup>104</sup> High Pay Commission, More for Less.

<sup>105</sup> J. Ang, G. Nagel and J. Yang (2009) 'The effect of social pressures on CEO compensation', SSRN paper, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1107280](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1107280). Also referenced in Hutton (2011) Fair Pay Review

<sup>106</sup> T. Kirchmaier and K. Stathopoulos (2008) 'From fiction to fact: the impact of CEO social networks', LSE Financial Markets Group discussion paper 608.

Indeed the view that executives can only be motivated by money appears to be part of a strong 'anti-management' sentiment that is central to agency theory.

While it is not clear whether pay has been linked to performance, it seems clear that it is associated with other determining factors.<sup>104</sup> One academic study in America found that pay increased based on the number of social comparisons available in a given geographical area or membership group (for example golf club or country club). Average pay for chief executives of S&P 500 companies with a

social circle of 82 other chief executives (the 75th percentile) was \$560,000 higher than for those with a social circle of just 15 chief executives (the 25th percentile).<sup>105</sup>

Further research has also shown that larger executive networks are associated with poorer company performance. This certainly suggests that chief executives are able to use their networks to increase rewards with little regard to company or personal performance.<sup>106</sup>

The concerns over the attempts to link executive pay to performance are only exacerbated by the conceptualisation of good performance that is predominant. This is a view which sees long term as limited to three years and performance as based solely on short-term shareholder returns, rather than a broader conception of what is good performance based on the extent to which the company provides affordable and needed goods and services, contributes to society and acts to mitigate risk or environmental degradation.

The pay and performance obsession has not linked pay to performance – there is no evidence that despite years of attempts it can be described as successful – but this experiment in executive pay has, however, increased the quantum. Attempts to link pay to performance have served to make executive pay increasingly complex and hard to understand. They have not only increased the total amount awarded, but have created an environment of obfuscation and even deception.

Pay awards for those at the top of our biggest companies are too complicated and this complication has not improved performance, but it has decreased transparency. In this environment it is almost impossible to ascertain what has happened to pay; for shareholders and the general public, this damages business and public trust.

### POLICY RECOMMENDATIONS

For the above reasons the Commission makes the following policy recommendations. While these policies focus on executive pay, it should be stated that this principle should apply across the private sector.

#### Simplify executive pay

As this report and others have argued, pay packets for those at the top of companies have become overly complicated. Driven by so-called innovation in pay, each layer of complication increases the quantum, and yet appears to have no positive impact on company performance.

Much of this innovation is exacerbated by the role of remuneration consultants who are brought in to design newer and more sophisticated rewards, driven by a desire to link pay to performance. The complication has knock on effects in damaging relations with shareholders, creating misconception, and encouraging confusion and obfuscation.

Innovation in pay, like innovation in financial products, has gone too far, which is why we are calling for executive pay to be returned to first principles. Executives should – like their workforce – receive a basic salary. This should be determined by the reformed remuneration committee (see below). It is right that companies determine the level of pay

appropriate to attract, retain and motivate their employees and it is right that this is done by a dedicated remuneration committee.

Additionally, we accept that the remuneration committee can elect to award an additional performance-related element if it is deemed necessary in the long-term interests of the company. It is the view of the Commission that this performance-related element should be measured over the long term and that long term should be defined as longer than the current norm of three years. We also support the recognition that the performance of the company should be judged on broader goals than simply meeting short-term shareholder interests. This is in line with public opinion, which believes that companies should be acting in the public good rather than purely for shareholder returns.<sup>107</sup>

It is important to note that equity-based bonuses are not unproblematic, as they can be subject to rises in value that have no relation to the performance of the executive and that executives generally place a lower value on long-term incentives and therefore demand a larger award.

Recognising these limitations, we recommend there should be an award of shares, the value of which is determined by the remuneration committee, with a five-year initial holding period and then a timed vesting of 20% each year

as the preferred option. Although other performance-related-pay options are available, we feel this is the simplest way of linking the interests of the executive to the shareholder. This simplification could also act to limit tax evasion and avoidance.

Simplification should initially be encouraged through a revision in the UK Corporate Governance Code. If this is not taken up as normal practice across the FTSE we would recommend a change in legislation.

In encouraging this, we also recognise that other reward structures may be preferable and recommend that additional research is conducted into the viability of a closer alignment of executive and workforce interest through profit share schemes, such as those operating in companies such as Greggs and John Lewis.

**Publish the pay packages of top 10 executives outside the boardroom**

The increase in transparency in pay at the top of companies has enabled shareholders and the public to have a greater understanding of pay in the boardroom. Yet, outside the boardroom relatively little is known about top pay.

We know almost nothing about the pay of those directly below board level, particularly how the ballooning in top pay has affected the pay of those directly

below them, or whether attempts have been made to link the rewards received by these executives to performance. To begin to address this we call on all companies to publish an anonymised list of their top ten highest paid executives outside the boardroom.

This is important to companies and shareholders, as ideally there should be an even transition in the pay they receive between top executives and the boardroom to ensure smooth succession to the top roles. To allay fears over the issue of confidentiality this could be done in bands, as shown in table 3.

This could be implemented through the UK Corporate Governance Code. If it is not implemented effectively by companies in this way, like other policy recommendations, this proposal may require a change legislation and the Commission would support this.

**Standardise remuneration reports**

This report has also highlighted the problems relating to the clarity of remuneration reports. It is apparent that remuneration reports have become overly complicated, and often relegate important aspects of remuneration to mere footnotes.

This complication ensures the lay reader, and indeed often the expert reader, struggles to understand not only how much is being paid, but also what it is

**TABLE 3 TOTAL REMUNERATION OF TOP TEN HIGHEST PAID EMPLOYEES OUTSIDE THE BOARDROOM FOR COMPANY A**

Pay bands	Pay	Number of employees
1	£2,500,000–3,000,000	2
2	£2,000,000–2,500,000	4
3	£1,500,000–2,000,000	2
4	£1,000,000–1,500,000	2

being paid for. One effect of this is that comparing reports across companies becomes increasingly difficult.

For this reason we recommend there should be a standardised form for remuneration reports that incorporates, but moves beyond, current best practice. The Financial Reporting Council (FRC) should work with companies and other key stakeholders to design it.

It is important that the template for the standardised form includes:

- a figure for the total remuneration received by the executives and a methodology for how it has been calculated
- standardised headings
- all ‘hidden’ benefits – the most significant being pensions
- a fair pay report (discussed further below).

If implemented by spreading of best practice or on a comply or explain basis through the UK Corporate Governance Code, this could allow variation where necessary to add clarity.

<sup>107</sup> Edelman Trust Barometer (2011) www.edelman.com/trust/2011/.

## 3.2 Accountability

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

The current model allows shareholders absolute oversight of the executive through voting rights at the annual general meeting.

This is a fundamental aspect of the UK corporate governance model. However, few of these owners are individual shareholders, indeed most are now larger investment funds, which invest both individual savings and our pensions. Transparency in this area varies: some funds fully disclose how they have voted on corporate governance issues, others only disclose to clients.

To improve transparency in this area we recommend that all investment funds disclose how they have voted on all issues of corporate governance, including executive remuneration. While it does not relate explicitly to the issue of pay, we emphasise that this principle should equally apply to all areas where shareholders have oversight, such as risk management and longer-term business strategy.

In the corporate world a blame game is going on. The majority of people who have met the Commission over the past year recognise that top pay has escalated dramatically and not been effectively linked to performance; they realise there is a growing public anger and even that something should be done about it. But whether it is shareholders, non-executive directors, remuneration consultants or the executives, it is always someone else's responsibility, someone else's fault.

These views make it clear that a system failure has occurred, which is of concern in relation not just to pay, but also to corporate performance, and begs the questions: who is really accountable, and to whom?

Accountability when it comes to top pay has been lost. Normal rules of competition have been suspended. The 'optimal contracting approach' – which see the self-interested executive bargain with the non-executive directors who act in the interests of shareholders – has broken down at the top of companies and the key elements needed for an efficient market are missing.

Looking specifically at the market in executive pay and the corporate governance arrangements which surround it, it is clear that reform to this structure of accountability is now necessary.

### THE MARKET IN EXECUTIVE PAY

The view that the principal agent problem can be managed with incentives is based on an arm's-length bargaining model or optimal contracting approach. For this model to be effective, shareholders must have absolute oversight, and their representatives, the non-executive directors, must bargain with the executive to determine top pay.

Since the Cadbury report,<sup>108</sup> all reforms aimed at tackling executive pay have empowered shareholders and given greater authority to non-executive directors. Yet this model has proved deeply problematic and its effectiveness in tackling this issue of executive pay is questionable.

The current market in executive pay relies on non-executive directors acting in the interests of the shareholders, to bargain with the executive, who is acting in his own personal interest, to reach a decision on a fair level of pay.<sup>109</sup> Shareholders in turn have a final say over whether the pay is acceptable through an advisory vote on the remuneration report at the Annual General Meeting.

### THE KEY ISSUES WITH NON-EXECUTIVE DIRECTORS

#### Board diversity

Most boards are made up predominantly of men from a managerial or financial background.<sup>110</sup> Many of these non-executives are either current executive directors at other companies or recently retired executives. While they have no direct financial interest in the company, they may have an indirect financial interest in the level of remuneration given to employees as a result of the benchmarking practices that are now common. This can further be considered problematic as it has been shown that individuals taken from the same background are more prone to 'group think'<sup>111</sup> and indeed more likely to reach a more extreme decision than groups made up of a more diverse selection of individuals.<sup>112</sup> Further, it is not clear to what extent this is being addressed. Currently only 19.2% of FTSE 100 companies provide a material statement on board diversity.<sup>113</sup>

#### Social pressures

Discussing pay is a distinctly difficult job, as is determining a person's financial worth. It is not surprising that this is challenging. This is only exacerbated by the fact that non-executives, if they are doing their job well, should be convinced they have the best team in place and wish to reward them appropriately. Pay

<sup>108</sup> Committee on the Financial Aspects of Corporate Governance, Report with Code of Best Practice.

<sup>109</sup> See F. H. Easterbrook (1984) 'Managers' discretion and investors' welfare: theories and evidence', Delaware Journal of Corporate Law 9; D. R. Fischel (1982) 'The corporate governance movement', Vanderbilt Law Review 35.

<sup>110</sup> Lord E. M. Davies (2011) Women on Boards, UK Council for Access and Equality, [www.ukcae.co.uk/pdfs/LordAbersoch-February2011-Womenonboards.pdf](http://www.ukcae.co.uk/pdfs/LordAbersoch-February2011-Womenonboards.pdf).

<sup>111</sup> R. A. Guzzo and G. P. Shea, 'Group performance and intergroup relations in organizations', in M. D. Dunnette and L. M. Hough (eds). Handbook of Industrial and Organizational Psychology, 2nd edn, Consulting Psychologists Press, 269–313, <http://tamuweb.tamu.edu/faculty/bergman/guzzo1990.pdf>.

<sup>112</sup> R. H. Thaler and C. R. Sunstein (2009) Nudge: improving decisions about health, wealth, and happiness, Yale University Press.

<sup>113</sup> Association of British Insurers (2011) Report on Board Effectiveness: highlighting best practice, encouraging progress, [www.ivis.co.uk/PDF/ABI\\_1684\\_v6\\_CS4.pdf](http://www.ivis.co.uk/PDF/ABI_1684_v6_CS4.pdf).

is a sensitive issue, and while we hope that non-executive directors will place the interests of the shareholders above social awkwardness, we recognise this may not always be the case.

### The dual role of non-executive directors

It is the role of the board not only to monitor the executive in the interests of shareholders, but also to support the executive in its decision-making. This dual role can cause difficulties for boards, particularly when making decisions on remuneration. The remuneration committee is made up of members of the board, and although they sit separately to make decisions on pay, this does not alter the existing board dynamic, which could inhibit constructive criticism or, as Jensen describes it, ‘the great emphasis on politeness and courtesy at the expense of truth and frankness’.<sup>114</sup>

### Fear of losing the CEO

Our research, suggests that losing a CEO to a competitor remains very unlikely. In a survey of CEO departures over the last five years in the FTSE 100, we found that the chance of having your CEO poached by a national competitor in any one year would be 0.2%.<sup>115</sup> The likelihood of having your CEO snatched by a global competitor according to this data series is zero. However, it remains the case that fear of poaching is encouraging generous rewards. While stock prices can be

highly sensitive to movement of CEOs and chief financial officers (CFOs) there is no evidence that such moves are more or less likely to affect firm performance over time.

### Weakest link

The process of benchmarking executives against a comparator group results in a ratchet effect, where all remuneration committees attempt to pay median or above salaries or performance elements. The consequence is that the system appears to be only as strong as its weakest link. It would take just one remuneration committee deciding to award a large pay packet, for example, out of fear of losing their CEO, to create a ripple effect impacting on all remuneration decisions.

### Superstar CEO

Boards increasingly set a lot of store on recruiting a big name executive, with the result that they overlook other candidates, limit the pool of talent available and so pay unnecessarily large remuneration.<sup>116</sup> Our research shows that an area of concern is the growth in externally appointed CEOs.<sup>117</sup> Most CEOs are internal appointments, but a large minority are external appointments: 41% of those surveyed. This proportion has increased over recent years – in 2002 only 35% of appointments were external.<sup>118</sup>

Internal succession planning is essential. There is evidence that companies with internal succession do better.<sup>119</sup> The best companies will have developed a pool of executive talent and succession is planned and often seamless. This keeps knowledge in the firm, creates bonds of trust across the organisation and emphasises continuity. It is what great companies have been doing for the last 200 years, and it makes sense. It should therefore be concerning that the practice of appointing CEOs internally is in decline, not simply because of the effect on pay, but because of the impact of this level of disruption on company performance.

### The effect of remuneration consultants

Remuneration consultants advise the remuneration committee on executive pay awards. However, there are widespread concerns over the role they play and potential conflicts of interest. While the UK voluntary guidelines for remuneration consultants prohibit cross-selling services, there is no evidence available to demonstrate whether this is the case or the extent to which it is being flouted. Remuneration consultants have played a significant role in determining executive pay and it is right that conflicts of interest in this area are eliminated.

Executive remuneration consultancy continues to be a small part of a number of larger firms’ business models and consequently there is a significant

pressure to cross-sell services. Further, anecdotal evidence suggests that this practice is widespread. Marc Jobling, the ABI’s former assistant director of investment affairs, agreed: ‘Pay consultants are a big contributor to the problems around executive pay. We have heard of some who admit they work for both management and independent directors – which is a clear conflict of interest and not acceptable.’<sup>120</sup>

### THE KEY ISSUES WITH SHAREHOLDER OVERSIGHT

In the UK shareholders are considered to be the absolute owners of companies and the key method through which to ensure a link between pay and performance is maintained, and to restrain pay if necessary.

Shareholders now have an advisory vote on the remuneration report and have an important influence on executive remuneration. A company’s remuneration report is prepared by the remuneration committee, which is made up of non-executive directors. This advisory vote of shareholders has led to a greater involvement of the larger investors in remuneration decisions and resulted in a number of embarrassing votes for companies.<sup>121</sup>

However, defeat over remuneration remains rare – even at the height of the financial crisis only five companies lost the vote on their remuneration report. On average the vote against the remuneration

<sup>114</sup> M. C. Jensen, ‘The modern industrial revolution, exit, and the failure of internal control systems’, *Journal of Finance* 48, 831–80.

<sup>115</sup> High Pay Commission (2011) *Global Mobility and Executive Pay*

<sup>116</sup> B. Groysberg (2010) *Chasing Stars: the myth of talent and the portability of performance*, Princeton University Press.

<sup>117</sup> High Pay Commission, *More for Less*.

<sup>118</sup> Manchester Square Partners (2006) *FTSE 100 Index CEOs: where do they come from and what do they do next?*

<sup>119</sup> High Pay Commission, *More for Less*.

<sup>120</sup> J. Treanor (2009) ‘Investors seeks [sic] curbs on executive pay advisers’, *Guardian*, [www.guardian.co.uk/business/2009/sep/15/guardian-executive-pay-survey-2009](http://www.guardian.co.uk/business/2009/sep/15/guardian-executive-pay-survey-2009).

<sup>121</sup> High Pay Commission, *More for Less*.

report was only 5.6% in companies covered in the FTSE All-Share Index in 2010. It was significantly higher in the FTSE 100 companies, which had an average of 8% of remuneration reports being voted down, up from 3.3% in 2006.<sup>122</sup>

Several issues are of concern relating to shareholders' role in the oversight of executive pay, which are discussed below.

#### The changing nature of shareholders

At the beginning of the 1980s only 3.6% of shares in publicly listed companies were held outside the UK. By 1990 this figure had increased to 11.8%, and by 2008 41.5% of UK listed shares were held by overseas investors. Simultaneously, there has been a decline in the percentage of shares held by long-term UK investors such as pension funds and insurance companies from over 50% in 1990 to 25% in 2008 (see table 4). The investors with whom we had discussions are aware of the problem of excessive reward, and particularly rewards that are out of line with company performance. However, those with a long-term holding in a company increasingly only make up a minor constituent of shareholders.

Most large shareholders, pension funds or institutional shareholders have a large portfolio and they often have an investment in hundreds of companies. As a result it is often not feasible for them to engage meaningfully with any

individual company over a sustained period of time.<sup>123</sup> There is little publicly available information on the extent to which investment funds and shareholders generally scrutinise corporate governance issues, including those of remuneration.

#### Time horizon

The effective time horizon of shareholders as measured by the frequency of turnover has also declined. Shares are now commonly held for a much shorter period than the time required to exert long-term discipline on company managers. Even long-term shareholders now hold shares for a shorter period of time than in the past; interviewees the Commission consulted suggest this period has decreased from 25 years to 10 years over the last decade.

#### The growing complication of packages

Executive pay packages have become increasingly complicated, as we discuss above. This has affected transparency and also accountability. It has become increasingly difficult to ascertain what level of reward is available for what level of performance, and against which criteria. Further awards, such as pensions, are hidden within footnotes in a company's annual report. Indeed, the total amount that an executive can or will receive is often in dispute, and it is often challenging to identify within remuneration reports the extent to which the rewards are tied to certain levels of performance.

#### Missing information

In a knowledge economy it is almost impossible to garner a key element of the information necessary to determine performance-related pay as we can never really know what the true value of each person's contribution may be. It is comparatively straightforward to measure how well a wall has been built, or how quickly a crop has been harvested, but determining what value has been added by any one employee in a large firm is much more difficult.

The success of a team, or indeed the success of a business, is not down to the efforts or expertise of just one individual. Determining the relative value and contribution of any single member of the business or team is, as a result, almost impossible.

#### The clarity of remuneration reports

Shareholders have an advisory vote on the remuneration report at the annual general meeting. However, these reports have become increasingly complicated and lengthy, with an effect on both transparency and accountability. This issue of concern has existed for some time and not improved. Many companies produce reams of data on remuneration – indeed it takes up an increasingly large section of most companies' annual reports – but present it in such a way that it is impenetrable to the lay, or indeed often experienced, reader. Many

remuneration reports would benefit from greater transparency and clarity.

The Hampel Report in 1998 stated:

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*4.16: Remuneration disclosures are often excessively detailed, to the point where the essential features of remuneration packages have been rendered obscure to all but the expert reader... We hope that it will be possible for the authorities concerned to explore the scope for further simplification and for listed companies themselves to present the required information in a form more accessible to the lay reader.<sup>124</sup>*

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This relationship between managers and owners is challenging. In the UK this is only exacerbated by the dispersed, as opposed to block, nature of shareholders. The ability of owners – shareholders – to exert influence over the company given their increasingly short-term time horizons raises questions about not only the issue of executive pay, but also and fundamentally whose interests these companies serve.

<sup>122</sup> PIRC (2010) Annual Stewardship Review, Pensions Investment Research Consultants.

<sup>123</sup> CBI, evidence to 2010 BIS review A Long-Term Focus for Corporate Britain: a call for evidence, Department for Business, Innovation and Skills, [www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain](http://www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain).

<sup>124</sup> Hampel Committee on Corporate Governance (1998) European Corporate Governance Institute, [www.ecgi.org/codes/documents/hampel\\_index.htm](http://www.ecgi.org/codes/documents/hampel_index.htm).

**TABLE 4 SHARE OWNERSHIP OF UK LISTED COMPANIES AS A PERCENTAGE OF TOTAL OWNERSHIP, 1981–2008<sup>125</sup> SOURCE: THE SHARE OWNERSHIP SURVEY**

	1981 (%)	1989 (%)	1994 (%)	2000 (%)	2004 (%)	2008 (%)
Rest of the world	3.6	12.8	16.3	35.7	36.3	41.5
Insurance companies	20.5	18.6	21.9	21	17.2	13.4
Pension funds	26.7	30.6	27.8	17.7	15.7	12.8
Individuals	28.2	20.6	20.3	16	14.1	10.2
Unit trust	3.6	5.9	6.8	1.1	1.4	1.8
Investment trusts		1.6	2	1.3	2.5	1.9
Other financial institutions	6.8	1.1	1.3	2.8	8.2	10
Charities etc.	2.2	2.3	1.3	1.4	1.1	0.8
Private non-financial corporations	5.1	3.8	1.1	1.5	0.6	3
Public sector	3	2	0.8		0.1	1.1
Banks	0.3	0.7	0.4	1.4	2.7	3.5
Total	100	100	100	100	100	100

<sup>125</sup> Office for National Statistics (2010) Share Ownership Survey, [www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/share-ownership/index.html](http://www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/share-ownership/index.html). 1 Includes investment trusts; 2 Public sector comprises local government, central government and public corporations; 3 The end-2008 survey did not identify any significant shareholdings of quoted shares owned by building societies; 4 The Share Ownership Survey has been conducted at irregular intervals since 1963, which leads to gaps in the time series shown here in tables and figures; 5 Components may not sum to the total due to rounding.

These flaws in the current model for determining executive pay highlight the problems in the ability of shareholders and non-executive directors to hold executives to account and determine a fair level of pay. They also reveal the fault lines in our current corporate governance system: most boards seek to

pay above the median, whether of salary or performance-related rewards, resulting in a ratcheting up of pay awards. It takes a very strong remuneration committee to seek to pay its executives below the median. It is seen as tantamount to admitting they are not up to the job.

Indeed what is increasingly clear is that what makes sense for one firm leads to a ratcheting up of pay if all companies do it.

The current structures of accountability for executive pay in particular have not been, and will not be, sufficient in ensuring that it is kept in check.

This report has recognised the issues inherent in the current structure of shareholder oversight and the role of non-executive directors in determining pay at the top. To begin the important process of addressing these accountability problems, we recommend the reforms listed below. The reforms put forward in this section tie in with those relating to transparency and attempt to ensure that increased transparency does not result in a ratchet effect or a race to the top.

Using the current structures, these reforms would involve the restructuring of remuneration committees, and make shareholder engagement easier and more effective, limit the effect of the ‘superstar CEO’ obsession and begin to tackle the issues that remuneration consultants raise.

We recognise that even if these reforms are implemented, the extent to which shareholders would engage is not clear. While making shareholder engagement easier and more meaningful, they do not address the fundamental issue of the changing nature of shareholders; it is beyond the remit of the project to explore this. We recommend there should

be further exploration into the potential for encouraging other forms of company ownership and longer-term share ownership.

### POLICY RECOMMENDATIONS

This Commission makes the following recommendations to create an environment of greater accountability. If implemented the reforms suggested in these recommendations will not only increase accountability, but also begin to deal with escalating top pay as part of a wider package of reforms focused on transparency and fairness.

#### Employee representation on remuneration committees

The current model of corporate governance locates absolute control in the hands of the owners, the shareholders and their representatives the non-executive directors. In the UK this model has failed to restrain escalating top pay. Further, it ignores the constructive role that other stakeholders can have when properly engaged.

As our research has demonstrated, remuneration committees remain a closed shop. Many continue to be made up of current or recently retired chief executives. This contributes to the dramatic growth in top pay, and the dislocation we have witnessed between average pay and the rewards given to some CEOs.

We therefore recommend there should be employee representation on remuneration committees. We use the term employee here to refer to any member of the workforce as a whole, including agency workers, casual workers and other individuals who do not fall under the legal definition of employee.

While some people have pointed out that this change will fundamentally alter the UK's unitary board system, it has become clear over the course of the last year's investigations by the High Pay Commission that the unitary board system is not effectively holding the executives to account in the long-term interests of the company over issues of pay.

This reform could fundamentally alter the structure of boards, and the way pay is determined. While it doesn't guarantee that we will instantly or always have a fair pay structure within companies, it does encourage and allow a greater engagement with the workforce on this issue, which may be constructive in mitigating some of the more negative effects on employee morale that larger pay gaps encourage.

It is important to add that the Commission sees this reformed remuneration committee as an essential part of the decision-making process on executive pay and pay policy. This reform is not to undermine the remuneration committee, but to ensure that it takes a more robust line in resisting pressure for higher pay.

Remuneration committees should operate on the principle that decisions about performance-related pay, when considered necessary, should be simple, clear and transparent; made in a way that can be easily assessed; and do not lead to an increase in the layers of complication we have seen in recent years.

As any employee sitting on the remuneration committee could end up as a 'lone voice' it is essential that they have access to appropriate training and support. As with employee representatives who act as pensions trustees, the Commission believes this can be effectively managed.

Companies could be encouraged to include employees on remuneration committees voluntarily, with the threat of legislation or fines if not enacted within a three-year period. The Commission feels that employee engagement is a fundamental issue for successful companies and therefore also recommends there should be further investigation into other ways in which employees could engage more generally and on issues of remuneration, through either direct representation or potentially a vote among employees.

#### **All publicly listed companies should publish a distribution statement**

One of the key issues the Commission has considered is how to encourage engagement from a dispersed shareholder base.

It has been suggested to the Commission that part of the reason for the low level of engagement from shareholders on issues of executive remuneration is the fact that the discussion on the growth of executive pay has been taking place outside the company context. Additionally, bigger shareholders, who hold a larger portfolio, do not commit the time and resources necessary to investigate properly the extent to which executive pay can be said to be linked to company performance.

The Commission recommends that all publicly listed companies should publish annually a statement of the distribution of their income over a period of three years, including showing percentage change from previous years. By providing information that goes back over a number of years, comparisons can be made and anomalies discovered – for example it would highlight when the workforce had had a 3% pay rise and the executive team a 10% increase.

The distribution statement could include:

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

This would be enlightening for shareholders and the public in all businesses, but particularly relevant in the banks where staff costs make up a

significant percentage of turnover. We believe the distribution statement should be standardised and presented on the front page of the annual report.

This recommendation could be implemented by a redrafting of the UK Corporate Governance Code or through a change in statute. As the distribution statement is largely to assist shareholders in making informed decisions it is more suitably an element of corporate governance, which should be implemented on a comply or explain basis. The Commission also believes it would be useful for further research to be undertaken to consider the extent that this distribution statement could be subject to a shareholder vote.

#### **Advisory forward-looking vote on remuneration reports**

Currently shareholders have an advisory vote on the remuneration report – this is backward looking and relates to decisions already made and implemented on executive pay. This creates an atmosphere of box ticking. There has been much discussion on whether this vote should be made binding. Having considered this and consulted shareholders, the Commission does not consider this vote should be binding at this stage, as shareholders have suggested that if the vote was binding it would deter them from voting against the report because they may lack the insider knowledge necessary to make a suitably informed decision.

Although fear of having a remuneration report voted down might encourage companies to engage with their shareholder more effectively, it was ultimately felt by the Commission that a preferred solution would be to shift the emphasis of the remuneration report to make it forward looking.

If enacted, the vote would therefore be on the remuneration arrangements for the three years after the vote is taken. This would include future salary increases, minimum bonus awards, on-target bonuses and maximum bonus awards, as well as current hidden benefits such as pension provisions. The shareholders would be voting on the total potential remuneration, and the potential pay outs of a performance element, if one is included, based on a range of outcomes. This would allow shareholders to have a genuine say in the remuneration package of executives rather than an advisory vote on a package that has already been implemented.

Before this proposal is implemented the Commission recommends that further research should be conducted, looking at how to ensure such a reform would be effective in encouraging shareholders to vote against excessive pay packages and not increasing the opaque nature of the disclosure.

#### **Improve investment in talent pipeline**

The growing propensity for hiring CEOs from outside a company appears to be

having an escalatory effect on executive pay. Seamless succession is important to a company, and ensuring there are high-quality internal candidates can have a positive effect on pay and company performance.

In the short term to encourage this we recommend that all companies implement a defined and structured talent pipeline to ensure there is a suitable executive successor who can come from within. Evidence suggests that a ratchet up in executive pay is being encouraged both in the quest for the ‘superstar CEO’ and the obsession with bringing in new talent.

While companies should retain the option hiring from outside, internal candidates should be the preferred option. This can be encouraged through soft schemes and encouraging best practice with an annual award for the best training programme. Additionally, all publicly listed companies should publish how they encourage and nurture talent in their annual report. This should include information on:

- how many women and individuals from ethnic minorities are on their internal management training programme
- what the criteria are for joining the management training programme
- what level of investment the company is including in its management training programmes.

This would ensure that talent is nurtured within companies and there are suitable successors available within a large company.

#### **Advertise non-executive positions publicly**

As discussed above the Commission also recognises that the make-up of non-executive directors, who determine executive pay deals, could be having an inflationary effect on pay. Even looked at in the most positive light, non-executive directors often come from a relatively small pool of individuals. We welcome moves to improve women’s representation on boards, and the recommendations put forward in the Davies Review,<sup>126</sup> and believe that this should go further.

To further open out remuneration committees that are currently made up of members of the main board, we recommend that all recruitment for positions on company boards as non-executive director should be published publicly.

This would begin to increase diversity on boards and make the appointment of non-executive directors more transparent and open, and act to reduce the closed shop mentality of appointments to non-executive positions.

#### **Reduce conflicts of interests for remuneration consultants**

As discussed above, the Commission is concerned at the extent to which

remuneration consultants are encouraging the ratcheting up of executive pay. In particular we are concerned that remuneration consultants have a direct conflict of interest, where they provide executive pay advice and cross-selling for other business.<sup>127</sup>

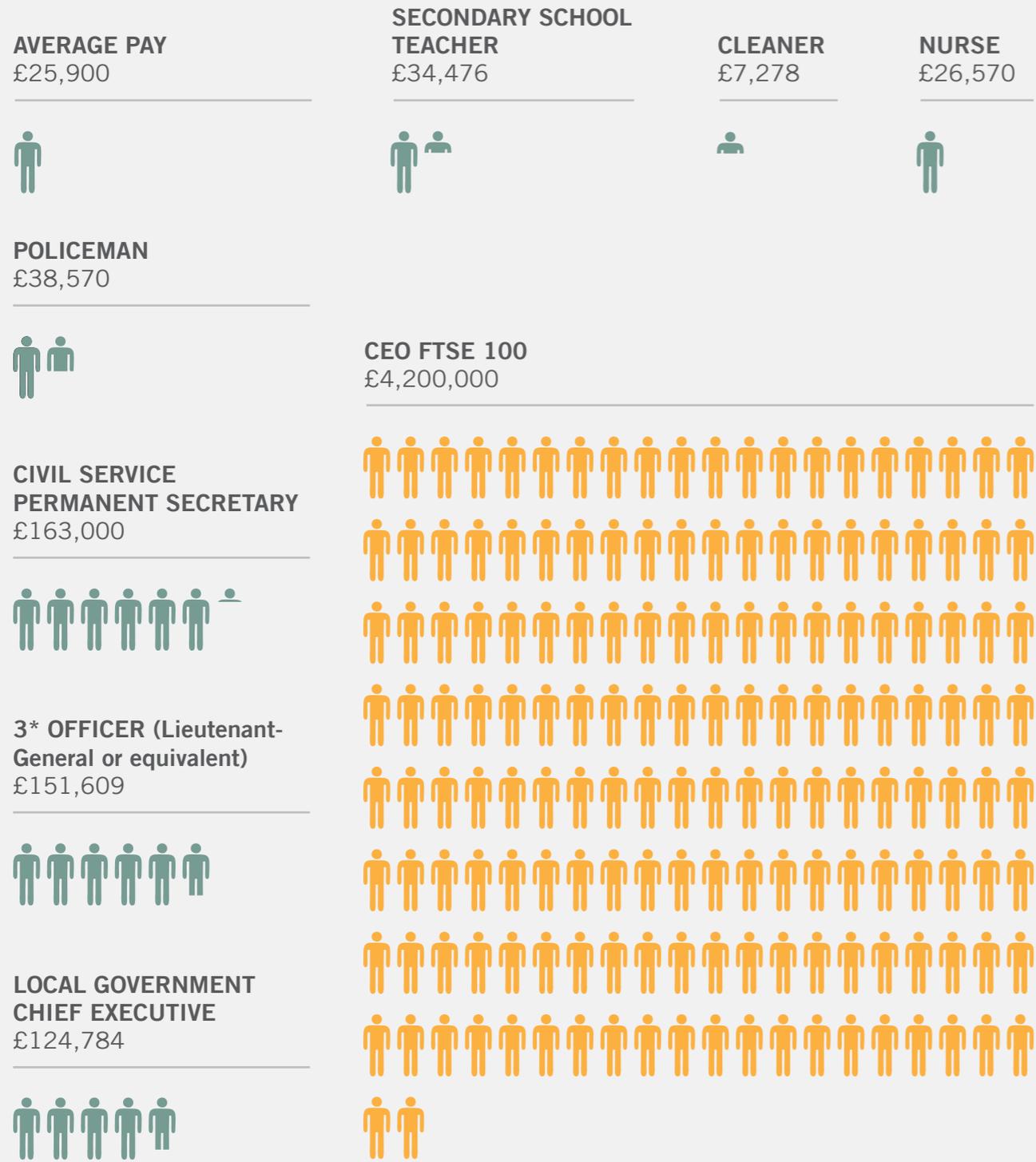
While the voluntary code for remuneration consultants specifies that they should not cross sell services, anecdotal evidence and interviewees the High Pay Commission met during this research suggest this practice is widespread.

In the first instance, we recommend that all companies publish the extent of services provided by their remuneration consultants. However, we recognise that this may not be sufficient in ending cross selling, and further reform may be necessary.

<sup>126</sup> Davies, Women on Boards.

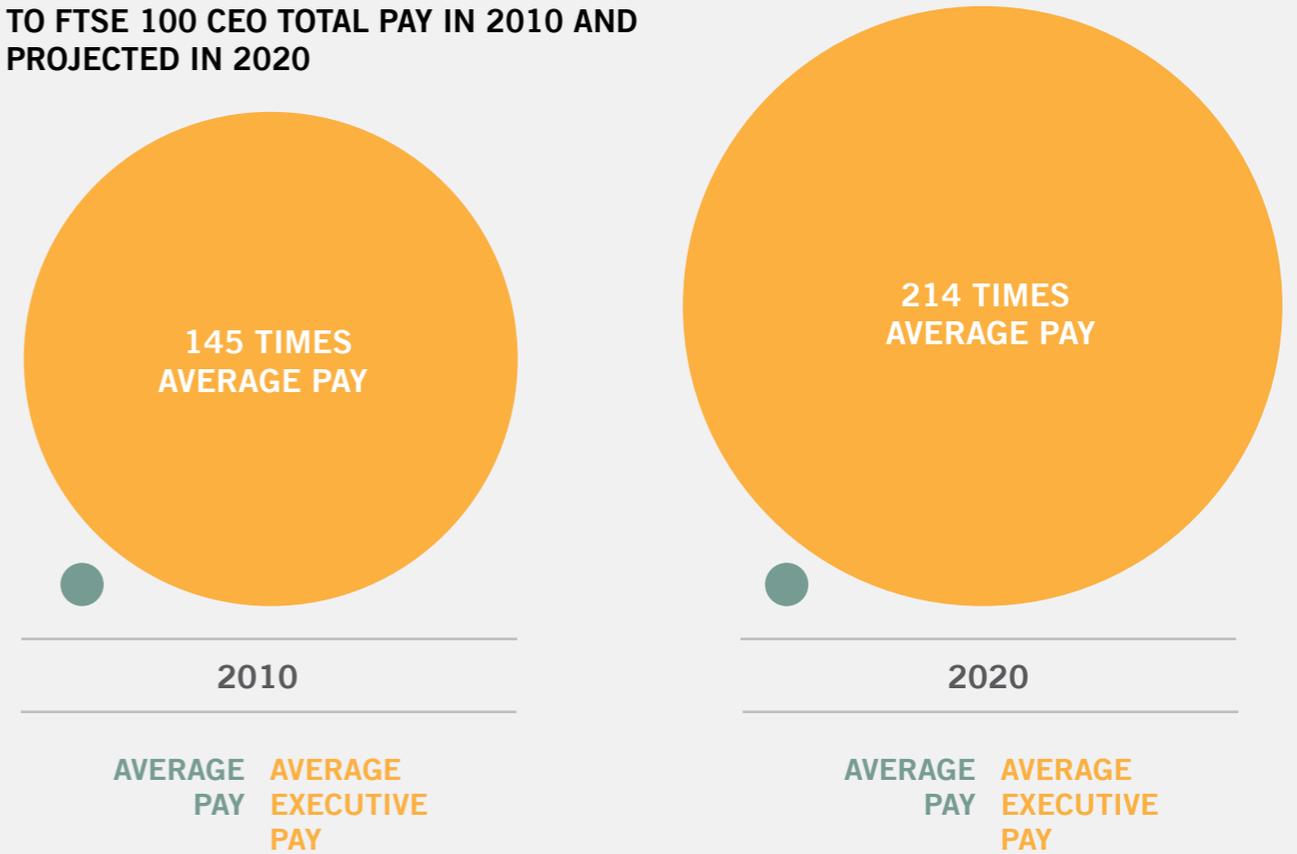
<sup>127</sup> By cross-selling the Commission is referring to the practice of providing the remuneration committee with executive remuneration advice, and providing the company with other chargeable services such as management consultancy.

**COMPARISON OF AVERAGE PAY IN 2010**

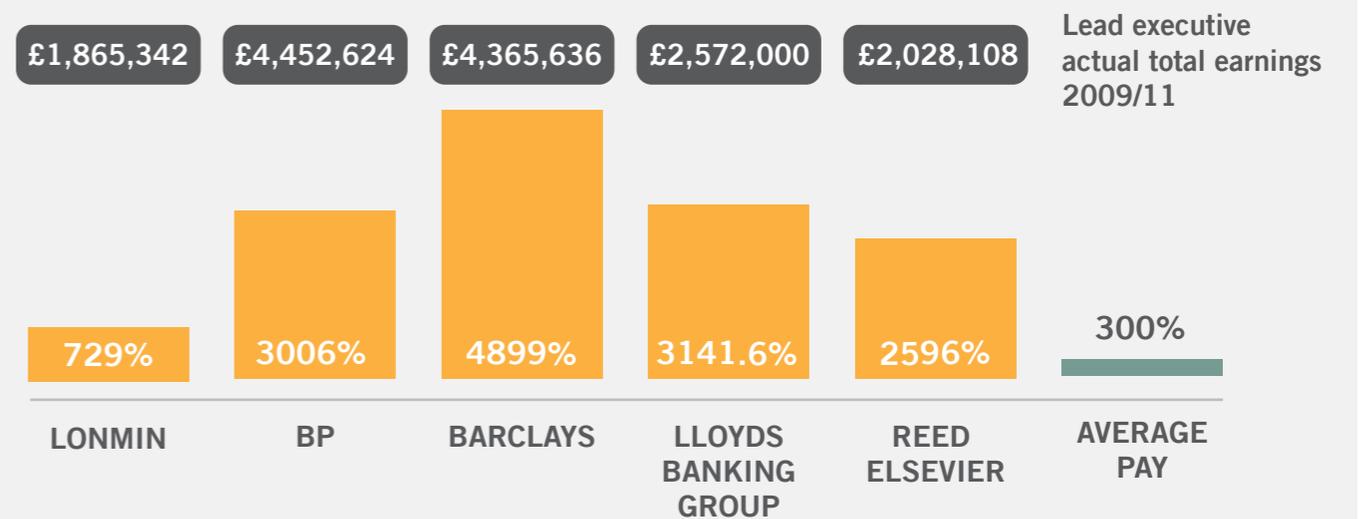


• See Annex 3 for source referencing

**AVERAGE PAY FOR WORKERS COMPARED TO FTSE 100 CEO TOTAL PAY IN 2010 AND PROJECTED IN 2020**



**LEAD EXECUTIVES TOTAL EARNINGS INCREASE 1980-2009/11 (%)**



• See Annex 3 for source referencing

### 3.3 Fairness

Fairness is a concept that everyone recognises is important. However, its ubiquity in public policy discourse can devalue its currency. In this report we use fairness to underpin our recommendations.

Without a sense of fairness and understanding of what is fair and acceptable pay, all the accountability and transparency in the world will not help to tackle the growing gap between the top and the bottom, or indeed top and the rest, not just in publicly listed companies, but across our economy.

If we lack a deeper understanding of why we are holding these companies to account, it may be irrelevant how good the remuneration committee is. As one chief executive put it, until executives genuinely understand how unfair excessive remuneration is or feel ashamed to receive it, there will always be special pleading and each special case affects the whole – rippling out through the benchmarking process.

Ethics in business goes much further than executive rewards, but fair pay is a good place to start. As this report has shown, the problems exemplified in the current debate on executive pay reflects those in other areas – whether it is the long term interests of the company, or the definition of success – pay is a microcosm of the flaws in our business model played out on a stage for all to see.

Over the last 30 years we have lost touch with what fair pay is. Indeed it has been undermined by a process that simplified

individual motivation to that of self-interest – ignoring the importance of professional ethics, broader aspirations and leadership.

For this reason, it is essential to restore to pay – not just at the top but across the board – the principle of fairness. A sense of fairness is important: when pay is perceived to be unfair, it affects motivation, employee engagement and trust.

To do this, we must first understand what we mean by ‘fair’ when it comes to pay, and how we can influence it.

#### WHAT IS FAIR PAY?

*I get paid enormously and at no great credit to me. I was lucky at birth. I shouldn't delude myself into thinking I am some superior individual because of that.*

Warren Buffett, Chairman and CEO of Berkshire Hathaway

Fairness has always been part of the British psyche. We have a distinct sense of what is fair. But although the concept is deeply entrenched in our collective consciousness, it also appears elastic. All political parties are now parties of fairness; what is there to dislike about fairness?

Yet even as the meaning of the word is stretched, there remains an important core, which if violated goes against our emotional response. It feels unfair when a convicted thug is allowed to win a million pounds on a TV game show; it feels unfair when a banker walks away with millions after crashing the system; and it feels unfair when the boss gets a large bonus even as his staff are seeing real-term wage cuts.

Our sense of fairness is as much defined by our sense of what is unfair. We see unearned rewards as unfair. In business it cannot be fair to be paid more when the very criteria against which judgements are based are pointing at failure rather than success. And it cannot be fair when rewards are so large they could not be earned.

What is fair in modern corporate Britain is a fundamental question, yet what is deemed fair or unfair is not fixed. Indeed, when conducting focus groups with highly paid individuals, Ipsos Mori working for the High Pay Commission found that the prevalent discourse around work has changed. Reward was more closely associated with systemic unfairness than with just rewards for hard work and effort. Indeed these high earners saw themselves as lucky, rather than deserving.<sup>128</sup>

Additionally what is fair reward is not seen in isolation; it is relative. What is fair, and what one is entitled to, is based on what one's peers receive. In our research we also found that reward and entitlement among high earners was

based on what their peers received. Some CEOs we interviewed went so far as to describe it as a way of keeping score.

However, as we have discussed, while rewards are deemed fair or unfair based on what our peers may be taking home, so too we look up the corporate ladder in discerning what is fair reward. In doing so, many have a sense of injustice.

We are happy to accept a level of inequality, as long as it is perceived as fair. Yet when rewards are seen to be so large they cannot be earned, it is perceived as unfair. In Bamfield and Horton's study individuals were critical of high salaries on the grounds that they are 'more than anyone needs'.<sup>129</sup> Equally Ipsos Mori found that rewards that were more than a person could reasonably spend were seen as too high.<sup>130</sup>

It has been suggested that luck is an important element to consider when determining whether a reward is fair or unfair. In his review of fair pay in the public sector Will Hutton called for rewards based on due deserts, where fair pay is determined by the demands of the job and the efforts of the individual, but where individuals are not punished or rewarded for brute luck.<sup>131</sup>

This raises important questions about the extent to which it is possible to discern whether an individual's successes are down to their effort, skills and judgement and what is down to luck. As Warren

<sup>128</sup> S. Castell (2011) Just Deserts, or Good Luck? High earners' attitudes to pay High Pay Commission.

<sup>129</sup> L. Bamfield and T. Horton (2009) Understanding Attitudes to Tackling Economic Inequality, Joseph Rowntree Foundation.

<sup>130</sup> Castell, Just Deserts, or Good Luck?

Buffett noted, he is lucky that he lives in a society that values his talents. More specifically, much of our individual success depends on the social and economic infrastructure. In a business the success of the whole is not determined by the contribution of just one person at the top; it is a sum of its aggregate parts.

Luck it seems goes deep. We all have unequal starting places, and unequal talents. Cricketers who play their first game at home go on to do far better than those who play their first game away. This luck follows them throughout their career. Should the cricketer who plays his first game away be compensated for the bad luck at the start of his career? To do so would be to recognise that his future career is influenced by this lucky or unlucky event. Yet to compensate each occasion when luck intervenes would be an almost impossible task. Such a task begins with how you define what is luck, and how far you should go in determining what reward is fair, based on effort, and what is affected by luck.

To attempt to implement a form of reward that removes luck from the system is not necessarily to create a fairer system of reward.

In his discussion of what fair pay is Hutton drew attention to an importance of the demands of the job.<sup>131</sup> We agree and suggest that rewards should also ensure that the right person is in the right position. It is in the interests of companies, our economy as a whole and our society that

those who would excel at engineering become engineers, but equally that those who would become good doctors or teachers are not deterred by the gap in rewards. Rawls in *A Theory of Justice* determined that reward should be based on the difference principle: that any difference in reward should be based on whether it will assist the poorest in society. Thus rewarding executives more – to ensure the best people seek the role – can be seen as a fair distribution of resources to an extent.

In a corporate environment fairness has a different tone. It is not simply what feels right, but what is right for the business. But these two factors are not mutually exclusive. As we have demonstrated, high levels of pay inequality are damaging for businesses and determining what fair pay is increasingly important.

### HOW DO YOU DETERMINE FAIR PAY?

The question remains: do we pay fairly in modern society? A glance at some of the numbers involved would suggest not. Can any one person be 4,000 times more valuable than any other? Does anyone need £9 million a year? Is a boss worth 100 of his workers?

Fair pay is about recognising the needs of the economy and society, to ensure that the right people are motivated to perform the right jobs. When pay goes wrong it can have damaging economic and social effects, as has been argued at length above.

What would fair pay involve? Is it about skill? Market value? Or effort? Is it a more social calculation about getting the right person into the right job? We want smart and motivated people to work in our banks and run our companies but we also want them to be engineers, doctors, teachers and politicians.

For top pay to be fair it needs to be awarded in a way that recognises differences, but not so much that it devalues others' efforts by creating such large differentials their worth is undermined in comparison. It can if necessary include a performance element that is simple to measure and understand, and be clearly linked to the individual's or team's unique contribution. Such a performance element should be transparent to all and capable of going down as well as up, based on clear performance criteria.

Understanding this it is right to repeat that one report cannot and indeed should not dictate what fair pay is. In this light we do not so much see this report as being the last word on what fair pay is but more the opening sentences.

The policies recommended in this section attempt to encourage wider public debate with business and government about what fair pay is, which the Commission feels is essential.

### POLICY RECOMMENDATIONS

As part of what the Commission considers an important cultural shift we make the recommendations listed below.

#### Produce fair pay reports

All publicly listed companies should produce a fair pay report, as part of their remuneration report highlighting key principles they conform to when determining what fair pay is across the company. As part of these reports companies should publish their pay ratios from top paid employee to company median over a period of three years.

There has been much debate about whether a ratio between top and bottom pay should also be included; however, the Commission at this stage recommends that the ratio between top and median pay is the figure published. The Commission reached this decision as it was felt that a top to bottom pay ratio is easier to manipulate than a top to median pay ratio, and recording the ratio of top to median pay provides a greater understanding of pay across the company.

Further research should be conducted into the viability of ensuring that this figure also includes contracted out services – helping to minimise the ability of companies to manipulate the figures. Additionally further work should be carried out into whether including a top to bottom pay ratio would be of additional value to stakeholders in determining whether there is a fair pay policy throughout the company.

The publication of a pay ratio would allow closer scrutiny of the pay gap in companies. The Commission particularly feels that this

<sup>131</sup> Hutton, Hutton Review of Fair Play.  
<sup>132</sup> Ibid.

# Conclusion

would allow greater understanding of changes over time and potentially across sectors. While the Commission has included this in its recommendations and considers it an important element of reform, it should not be seen as a silver bullet, as alone it is unlikely to have a significant positive impact on pay.

If forced to produce fair pay reports as part of the Remuneration Report, which include the pay ratio and statements of fair pay principles, companies will be encouraged to consider the pay across the company when setting executive pay, as is required by the UK Corporate Governance Code, as well as to consider how their pay policy can be considered fair in a broader sense.

This recommendation could be implemented through the UK Corporate Governance Code on a comply or explain basis, although again it may be necessary to use legislation to ensure it is implemented.

## **Establish a permanent body to monitor high pay**

High pay is an issue not just in publicly listed companies, but in the wider economy as well. It is not just in our boardrooms but in our banks that pay has escalated to levels that a few decades ago would have been unimaginable. While the focus of this report has been on reforms that could improve disclosure and increase accountability in the boardroom, the Commission recognises that this is not the only place where pay has escalated dramatically over the last 30 years.

In conducting this commission we have been astonished at how limited available information is on what has happened to pay at the top. This must be rectified to enable an informed public debate.

We therefore call on the government to establish a permanent body to monitor pay at the top. This permanent body should report annually on the state of pay and have access to HM Revenue & Customs data on pay and other currently inaccessible sources.

This permanent body should:

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

Additionally, the Commission is concerned that the only voices which are heard in relation to pay are those of shareholders; we therefore recommend that this permanent body should assess public opinion annually.

A permanent body to monitor high pay could function on a social partnership model, similar to that used by the Low Pay Commission, to engage with the public, business and trade unions in determining what fair pay is. Indeed as this process develops it may be appropriate for businesses to be encouraged to respond to this debate in their revised remuneration reports.

Pay matters: who gets what and how they are paid affects how people behave. In a business it affects motivation and engagement. In our economy it affects social mobility, entrepreneurialism and potentially impacts on growth. The status quo is no longer acceptable or sustainable; action is required.

When pay is deemed unfair, it has damaging effects on organisations. When the leaders of companies are given disproportionately higher rewards, employees cannot help but feel that different rules apply to their bosses. This undermines trust and their commitment to the business.

In looking into what has happened to pay at the top, this investigation has been forced to explore what too has been going on in our businesses. It is clear from this investigation that this wage inequality is part of a toxic form of free market capitalism – a winner takes all system that allows monopolies to accrue and discourages the entrepreneurialism it is meant to facilitate.

This issue goes deeper than high pay; this debate is fundamentally about not just who gets what, but also how businesses should behave, and what our economy should look like. This government has called for a rebalancing of the economy and we support this call. In getting there, we must move away from an economy predicated on a flow of rewards to the top.

A business model where corporate profits accrue in the hands of the few is deeply flawed and over the long term unsustainable. We urge government and businesses to take on board the findings of this Commission and act now to begin the process of restoring trust and building a fairer, more sustainable economy.

# Annexes

## 1| The expert panel

The Expert Panel is a group of experts on high pay. They come from all parties and none, and represent a cross-section of interests – business, academia, civil society, the media and trade unions. Individuals serve on the Expert Panel in an individual capacity and not as a representative from their place of employment.

**David Bolchover** is a writer on management and the workplace. He is the author of three business books, the latest being *Pay Check: are top earners really worth it?* (Coptic Publishing, 2010).

**Sally Bridgeland** became CEO of BP Pension Trustees Limited in July 2007. She has extensive pensions and investment knowledge, gained through over 20 years' experience with the leading benefits consultancy Hewitt Associates. A qualified actuary, Sally currently chairs the UK actuarial profession's management board.

**Jane Fuller** is an independent consultant working in media and investor relations, and public and private business research. She is consulting editor of *Financial World* magazine and a trainer of journalists for the *Financial Times*. Jane has just written a report for the Centre for the Study of Financial Innovation on Regulation entitled *Principles in Practice*.

**Lord Christopher Haskins** is a cross-bench life peer. He became the director of Northern Foods in 1967, deputy chairman in 1974 and chairman from 1980 to 2002. He has also been chairman of the Better Regulation Task Force and a member of the New Deal Task Force. He is a fellow board member of Yorkshire Forward and chairman of the Council of the Open University.

Alan MacDougal is the managing director of PIRC, the UK's leading independent research and advisory consultancy, which provides services to institutional investors on corporate governance and corporate social responsibility.

**Jonty Oliff-Cooper** is the director of policy and strategy for the social business A4e. His work focuses on exclusion, community and public service transformation. He began his career in the private sector as a strategy consultant at the Boston Consulting Group, specialising in retail strategy. Jonty has worked in a variety of strategy and advisory functions in Westminster and Whitehall, including at the Department for International Development, the Cabinet Office, ThinkPublic and the Conservative Party Policy Unit, where he led on technology, innovation and public service reform issues. Before joining A4e, Jonty was head of the Progressive Conservatism Project at the think-tank Demos.

**Kate Pickett** is joint author of *The Spirit Level: why more equal societies almost always do better*. She is Professor of Epidemiology in the Department of Health Sciences at the University of York, a member of the Health Inequalities Research Group and the National Institute for Health Research Career Scientist, and a fellow of the RSA.

**Andrew Simms** is the director of policy at nef (the new economics foundation). He was co-author of the groundbreaking report on the Green New Deal, and co-founded the Green New Deal group. Andrew writes regularly for the national press and is on the boards of Greenpeace UK, the climate campaign 10:10 and the Energy and Resources Institute Europe. He worked for many years for international development organisations, writing extensively on issues of climate change and poverty reduction.

**Polly Toynbee** is a columnist for the *Guardian*. She was formerly BBC social affairs editor, columnist and associate editor of the *Independent*, co-editor of the *Washington Monthly* and a reporter and feature writer for the *Observer*. She has written several books, including *Hard Work: life in low-pay Britain* (2003) and *Better or Worse? Has labour delivered?* (2005) co-authored with David Walker.

## 2| People the Commission met

**Rod Aldridge**, Aldridge Foundation  
**George Alford**, Investec  
**David Arnold**, Unison  
**Amra Balic**, Blackrock  
**Andy Banks**, Legal & General  
**David Bolchover**, Author  
**David Boyle**, nef  
**Tony Braine**, British Land  
**Amanda Breen**, Fair Pensions  
**Alan Brett**, Manifest  
**Sally Bridgeland**, BP  
**Stella Brooks**, Inbucon  
**Alex Bryson**, NIESR  
**Prateek Buch**, Social Liberal Forum  
**Vince Cable MP**  
**Sarah Castell**, Ipsos Mori  
**Ian Cheshire**, Kingfisher  
**Vineet Chibber**, JP Morgan  
**Gordon Clark**, Kepler Associates  
**William Claxon-Smith**, Manifest  
**Paul Deane-Williams**, TowersWatson  
**Emily Delios**, NAPF  
**Alain Dromer**, Aviva  
**John Earls**, Unite  
**Adam Elstron**, IDS  
**Paul Emerton**, Schroders  
**Duncan Exley**, One Society  
**Jane Fuller**, Fuller Analysis  
**Lord Robert Gavron**  
**John Goodman**, Co-Operatives UK  
**Tim Goodman**, Hermes  
**Richard Grayson**, Goldsmiths  
**David Hall-Mathews**, Social Liberal Forum  
**Lord Christopher Haskin**  
**Alastair Hatchett**, IDS  
**Tim Horton**, Fabian Society  
**Catherine Howarth**, Fair Pensions  
**Will Hutton**, Fair Pay Review

## 3 | Information on data

**George Irvin**, SOAS  
**Nick Isles**, Corporate Agenda  
**Eugenia Jackson**, F&C  
**Natalie Jacolett**, CWU  
**Roger Jeary**, Unite  
**Marc Jobling**, ABI  
**Guy Jubb**, Standard Life  
**Jeannette Ladzik**, FES  
**Neal Lawson**, Compass  
**Kayte Lawton**, IPPR  
**Carole Leslie**, Employee Ownership Association  
**Baroness Ruth Lister**  
**Tony Lloyd MP**  
**Alan Macdougall**, PIRC  
**Georgina Marshall**, Aviva  
**Jim McNally**, BT  
**Martin Mclvor**, Unison  
**Kennedy McMeikan**, Greggs  
**Peter Montagnon**, FRC  
**Jesse Norman MP**  
**Sean O'Hare**, PWC  
**Jonty Oliff-Cooper**, A4E  
**Martin O'Neil**, University of York  
**Chi Onwurah**, MP  
**Karim Palant**, Ed Ball's Office  
**David Paterson**, NAPF  
**Kate Pickett**, University of York  
**Ashok Pillai**, BP  
**Tom Powdrill**, PIRC  
**Michelle Quest**, KPMG  
**Howard Reed**, Landman Economics  
**Hugh Savill**, ABI  
**Helmut Schuster**, BP  
**Neil Sherlock**, KPMG  
**Andrew Simms**, nef  
**Anita Skipper**, Aviva  
**Nicola Smith**, TUC  
**Karl-Heinz Spiegel**, FES

**Daniel Stilitz QC**, 11KBW  
**Dan Summerfield**, USS  
**Jake Sumner**  
**Steve Tatton**, IDS  
**Polly Toynbee**  
**Lord Andrew Turnbull**  
**Chuka Umunna MP**  
**Catherine Usher**, PWC  
**Cliff Weight**, MM&K  
**David White**  
**Giles Wilks**, Vince Cable's office  
**Stephen Williams MP**  
**Trelawney Williams**, Fidelity  
**Janet Williamson**, TUC  
**Douglas Wilson**, Standard Life  
**Andrew Witty**, GSK

### Table 1/2 Company Pay Data Comparing 1980-2011

Caveats to be taken into consideration:

- Employee figures are taken from current annual accounts are based on global wagebills and global headcounts and are based solely on continuing operations where relevant, whereas the 1980 figures are based on the UK-based part of the company only.
- The structure of the companies themselves will have changed quite dramatically over the three decades in question.
- Lloyds Bank is one organisation to look at in particular in terms of corporate transformation – because of the company incorporation act (which came into effect just after the 1980 data was recorded), the bank was able to swell into the global investment giant it is today.
- Though Reed International has merged with Elsevier NV, we have included it in the list as the new Reed Elsevier plc maintains largely the same portfolio as the Reed International did before the merger.
- For companies with significant operations outside the UK – like BP – currency fluctuations will have a significant impact on staffing costs.

### Source Referencing Information for Infographics

### COMPARISON OF AVERAGE PAY IN 2010

Average pay – relates to average full time earnings 2010 £25900 – *Source: Annual Survey of Hours and Earnings*

Secondary School Teacher, Cleaner, Nurse – *Source: Annual Survey of Hours and Earnings*

CEO FTSE 100 – *Source: Incomes Data Services (2010) Directors Pay Report*

Permanent Secretary (Civil Service), 3\* Officer (lieutenant general or equivalent), Local Government Chief Executive – Based on estimates accurate in 2009 to provide an indicative picture – *Source: Hutton (2011) Fair Pay Review*

### AVERAGE PAY FOR WORKERS COMPARED TO FTSE 100 CEO TOTAL PAY IN 2010 AND PROJECTED IN 2020

Average executive salary – Includes all earnings and is estimated here as 3.747m for the CEO in FTSE 100 companies 2009/2010. Note this figure is different from the figure calculated by Incomes Data Services for the equivalent period due to the difficulty in calculating accurately the total earnings. We have used both figures to provide the fullest picture possible bearing in mind the limitations in the data – *Source: MM&K/Manifest MM&K and Manifest Data on executive pay. Data taken from Manifest, The Executive Director Total Remuneration Survey 2010, September 2010.*

Average Pay – relates to average full time earnings for the year 2010 which was £25900 – *Source: Annual Survey of Hours and Earnings*

### **LEAD EXECUTIVES TOTAL EARNINGS INCREASE 1980-2009/11 (%)**

Executive pay data – *Source: Incomes Data Service provided to the High Pay Commission. Full data available in table 2. See above for necessary caveats.*

Average Salary Increase – based on calculation by the High Pay Commission. Average Salary in 1980: £6,474 – *Source: New Earnings Survey 1980. Average Salary 2010: £25,900 – Source: Annual Survey of Hours and Earnings.*

### **TOP 0.1% SHARE OF NATIONAL INCOME IN THE UNITED KINGDOM 1900-2035**

*Source: F Alvaredo et al. (n. d.) The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>. 1913-2007. 1900-1913 and 2007-2035 based on High pay Commission projections.* Notes: data from 1993-2007 relates to income share adults as opposed to income share tax units; Up to 1920, estimates include what is now the Republic of Ireland. Until 1974, estimates relate to income net of certain deductions; from 1975, estimates relate to total income. Until 1989 original estimates relate to tax units (married couples and single adults), while, from 1990, original estimates relate to adults; they are presented in two distinct columns. When possible, a linked “continuous” series is provided beyond 1989 under the label ‘tax units.’ (November 2010)

### **TOP 0.1% SHARE OF NATIONAL INCOME. UNITED KINGDOM COMPARED WITH THAT OF OTHER COUNTRIES.**

The Top 0.1% in the UK consistently take home a larger percentage of national income than in other countries with the exception of the US. The figures provided here paint an indicative picture. For full details see source. *Source: F Alvaredo et al. (n. d.) The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>. (November 2010)*

### **BY 2035 THE TOP 0.1% WILL TAKE HOME 14% OF THE NATIONAL INCOME. EQUIVALENT TO THAT SEEN IN VICTORIAN ENGLAND.**

*Source: F Alvaredo et al. (n. d.) The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>. See above for notes on data.*

### **WHAT HAS HAPPENED TO AVERAGE PAY OF ALL FTSE 350 DIRECTORS AND AVERAGE CORPORATE PERFORMANCE MEASURES BETWEEN 2000 AND 2010.**

*Source - Income Data Services (2011) What Are We Paying For? Exploring executive pay and performance, High Pay Commission. Note: median used instead of average to mitigate for the exaggerated impact of the dot.com boom in the early 2000s for Year End Share Price.*

### **ATTITUDES TO HIGH PAY**

*Source – British Social Attitudes Survey*