

## executive pay: a battle for hearts as well as minds

Mike Scott talks to Tom Powdrill of investor advisor Pirc, which wants an overhaul not just of the rules on executive remuneration but of the way that investors – especially trustees – view the whole scene

The issue of executive pay has become a lightning rod for public anger at the bankers who are widely seen as the architects of the credit crisis and the subsequent global recession.

At the heart of the debate on remuneration is Pirc, a UK-based research and advisory consultancy that recommends how investors should vote at company meetings on issues including compensation. 'We are not a campaign group, but we are advocates for sensible remuneration policies,' says Tom Powdrill, Pirc's head of communications.

Three UK companies have had their remuneration reports voted down this year – RBS, Bellway Homes and most recently Shell – and their fates illustrate a number of the issues that so incense people on the street when it comes to executive pay.

At Bellway, investors were upset that bonuses of £632,500 (\$1million) were paid to three executives despite a slump in the housing market that has driven the company to a loss. 'Investors had a problem with the company paying bonuses in a bad year and with it tweaking the performance conditions to allow them to be paid,' says Powdrill.

Meanwhile, RBS's vote saw UK Financial Investments, the government body that owns 70 per cent of the bank, lead a revolt against the notorious £17m pension package for former chief executive Sir Fred Goodwin that was agreed in spite of his role in pushing the company to the UK's biggest ever corporate loss of £24bn in 2008. The 90 per cent of votes cast against the company's remuneration report was the largest in UK corporate history.

But while the vote was a clear indication of the strength of feeling on the issue, it highlights another point – that the ballot had no force. 'Companies can ignore votes and do what they like,' Powdrill explains.

Perhaps even more shocking is that the Bellway, RBS and Shell votes were the first against remuneration reports since 2006 – during 2007 and 2008, as the credit crunch took hold, not one report was voted down.

'It was only last year that we started to see an increase in votes against remuneration plans, and even then the worst was passed with 81 per cent approval,' says Powdrill. 'What message were the banks supposed to draw from votes of 80-90 per cent in favour of their pay policies?'

Pirc suggests the UK authorities should consider whether votes ought to be binding 'or if there is another way for shareholders to have more teeth on remuneration'. However, it is clear that many investors failed to make use of the options that were available to them. Many investors disagree with certain company proposals – such as the row over Barclays' capital-raising from Qatar at the end of 2008 – but fail to vote against them because they do not want to destabilise the company.

However, the strength of this argument may be overstated. 'The pensions row has done a lot more damage to the reputation of RBS and the banking industry in general than if shareholders had voted against the remuneration report last year,' Powdrill points out.

Part of the problem is that those who vote – asset managers – come from a culture where bonuses are integral to pay packets. 'The idea that poor pay policies affect performance probably remains the niche view of SRI investors, although many of their clients may think differently,' he adds. 'But I would suspect there is more apathy than a conscious decision to approve massive pay packages. Unless there is something that seriously compromises shareholder rights, most investors are not that bothered.'

The solution, according to Powdrill, may be for asset owners such as pension funds to take more responsibility for the way fund managers vote on their behalf. 'The ultimate responsibility lies with asset owners. Pension funds should take responsibility for this issue themselves. Trustees are likely to have less of a 'City view' of compensation than asset managers – and fewer conflicts of interest.

'We think there are technical reforms that could be put in place, but they are only going to have an impact if shareholders are willing to use their rights. We need to look at how we get investors to take these ownership rights seriously.'

Pirc looks at a number of issues when examining remuneration reports, with concerns including targets in incentive provisions that are too easy to reach and general excessiveness – 'are the total rewards available reasonable?' Many packages have unchallenging targets that are often simply too high.

A factor that receives less attention is the idea of equity. While many executives spend a lot of time highlighting the differences between their pay and that of other senior managers, the comparison between executive pay and the average worker's has been ignored.

In Germany, the SPD political party reports that senior managers at the 100 biggest companies earn 43 times more than the average staff member, compared to 15-20 times more in 1996. Meanwhile, in the US, the Institute for Policy Studies and the not-for-profit group United for a Fair

Economy calculated in 2008 that the average chief executive of an S&P500 company was paid \$10.5m, more than 344 times the average US salary. Thirty years ago, the difference was 30-40 times.

There should be greater disclosure of the relative pay of staff and senior executives, argues Powdrill, including their pensions – which, as has been seen with RBS, offer significantly better benefits than those offered to ordinary workers.

Powdrill believes that either performance-related pay has created perverse incentives – mostly based on share price rises – or ‘people were acting in the dark and the level of remuneration was almost irrelevant’. Either way, he concludes, ‘I suggest we need to have a bit of a rethink’.

There has been some progress – including with UBS’s bonus/malus system, whereby bonuses can be clawed back if it can be proven that performance was mis-stated, while RIAA (the Responsible Investment Association of Australasia) has called for pay to be linked to social and environmental issues and long-term company performance.

‘The question is to what extent you can ascribe the performance of companies to the actions of a few directors,’ Powdrill says. ‘A bull market is a rising tide that lifts all boats. Despite that, when the market goes up, remuneration goes up a lot, while on the way down there is not an equivalent drop-off in pay.’

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