HOW FAT IS MY CAT?

"The salary of the chief executive of the large corporation is not a market award for achievement. It is frequently in the nature of a warm personal gesture by the individual to himself."

(John Kenneth Galbraith (1908 – 2006), Canadian born US Economist)

Transparency

Shareholders in quoted companies (PLCs), from the smallest investor with only a few shares to major investors such as Pension Fund managers and other financial Institutions in the City with thousands or millions of shares, should take a more active interest in the level of remuneration being paid to the Chairman, Chief Executive, Managing Director and other board level people in the companies in which they have invested. This is because they are the people who, rightly or wrongly, own the companies whether they are privatised utilities or banks that have been created from former building societies. The recent flotation of a number of former mutual building societies and the planned flotation of mutual insurance companies has increased the number of shareholders and increases the challenge to get things right.

Until the Cadbury, Hampel and the Greenbury committee reports, driven by the need to clean up corporate images and corporate governance, it was difficult trying to entangle who was being paid what in the boardroom. It was particularly difficult to discover how much was being channelled into non-salary elements of remuneration packages of senior managers, like pension schemes and share options, membership of clubs, provision of all forms of transport or the general terms of contract of each director.

Some company reports now appear to be falling over themselves in an effort to provide information on levels of boardroom remuneration but many, not only in UK but also in the US and Europe, still remain reluctant to be transparently open and honest. In addition to basic salary levels there is, hidden amongst the financial data in the report, information relating to share options, pension contributions and short and long-term bonus arrangements and quarterly and half-yearly schemes, all designed to boost the pay of senior management. But you sometimes have to search to find the data.

For many companies the annual report is a well-rehearsed formula. But, for others, it is also a lost opportunity for senior management to explain their thinking, their strategy for the way ahead, their approach and attitude to the environment and ethical issues, and, a way of telling shareholders, honestly, just how well the company is doing.

Shareholders might believe the Chairman, Chief Executive or Managing Director is worth a basic salary of say £390,000, which according to ***Management Today*** is the average wage for a top 350-listed company. Some even believe that the market decides the pay of a CEO because of the vote on the annual meeting report and disclosure of salaries and share options. However, if the Annual Report is silent on other significant financial detail in director remuneration packages then shareholders could be justifiably outraged. If they were to discover, for example, that with bonuses and other options the figure was £½ million and in many instances now more than £1 or £2 million, then they might not be quite so amused. There are, apparently, degrees of transparency; and, the real problem is that few if any shareholders ever question the pay of directors and the number of shares they have awarded themselves.

Companies need leadership, and good leaders need to be appropriately paid. An important part of leadership is the need for good governance that comes from integrity and openness and the acceptance of responsibility and accountability. But, what level of pay is appropriate for a senior director of a quoted company? There are those who would argue that, in the growing global marketplace, we should pay amounts similar to those paid in the USA. Why? And just who are the people who are continually driving up the wages and benefits of CEOs and other directors?

To the best of my knowledge CEOs and other directors are not globally mobile, even though there is an increasing requirement in the growing global village for international experience, and most senior managers in the USA, UK and Europe and probably the rest of the world are selected from among local candidates and often from company employees. Therefore, it should not follow that what is the standard in the USA should be the standard in Europe let alone the UK or indeed any other part of the world. There is no justification for such comparisons, which clearly are inappropriate.

So, what is the rate for the job? What are the qualities necessary to be a global CEO? There are many relevant factors to be considered. It is not just track record in other organizations but general levels of experience in company markets, education and training, interpersonal skills, financial credibility and man management ability. Availability of individuals with the optimum mix of qualities is also a factor.

The forces of supply and demand operate in the senior executive market as in other areas, however, I get the impression that people are selected for high office from among an elite bunch who just might belong to the same club, have gone to the same school or university or who have the contacts in other companies and organizations. It is not so much a cartel of executives but more a moral black hole that feeds on itself.

However, we are often told that in order to attract the most capable people a company must pay the going rate but who determines what that going rate is? That sounds like drivel dreamt up by those at the higher levels in order to maintain the 'status quo' and, besides, everything else in the capitalist system is based on competition so why not competition for the most senior management? Besides, if the system insists on paying the 'going-rate' for senior managers then why not for every level of worker throughout a company? Pay levels for workers in the USA are 25 to 30 per cent higher than in UK and the cost of living over there is cheaper than over here. And, pay levels for workers in some European countries, Germany, Holland and France for example, tend to be higher than in UK. Clearly what is sauce for the goose is not sauce for the gander!

The package for newly recruited top directors is usually the result of negotiations in the marketplace. Remuneration for already appointed directors is more of a lottery. Newly appointed CEOs are often selected with a view to enhancing shareholder value - achieved by improving bottom line profitability by such strategies as market or product development, cost reductions or acquisitions. In practice, priority is, too often, given to the latter two strategies, because these produce short-term results and not enough to earnings per share or comparison with other companies in the same area of business.

Such short-termism is often reflected in director's remuneration packages. The size of stock options awarded to the most senior management, usually at very competitive prices, often encourage managers to focus on short-term gain at the expense of longer-term growth of shareholder value.

Strategic development of the company can be frustrated by such remuneration practices, putting at risk the interests of most of the stakeholders, from shareholders to employees, from suppliers to bankers. It might be sensible to encourage, perhaps even insist, that senior management invest their own capital in the business.

Hardly a week goes by without some banner headline proclaiming how much a failed executive is to be paid for leaving a company. No matter the apparent circumstances companies appear obliged to pay out ludicrous sums in compensation. Compensation for what - lost markets, lost deals, a falling share-price or a warning on profits? Most shareholders recognise that a Chief Executive should be rewarded for successful performance. They get angry, as well they should, when a CEO is rewarded, generously, for failure. So, is it reasonable to suggest that today's senior businessmen are greedier than their predecessors? The simple answer must be yes but the more complex question is why then do people already on very high salaries and additional perks feel the need to twist and turn and even cheat in order to rake in even more money in the short term?

The real problem is that pay packages and share options for senior managers, more particularly in the USA but increasingly in the UK, are getting out of hand, one might even suggest excessive but if shareholders do not bother to turn up to annual general meetings then that gives directors a free rein. When directors can often double their annual salary by cashing-in share options it makes a mockery of basic pay packages and a mockery of the idea of allowing shares to encourage directors to work harder to improve productivity and competitiveness and thus profits. And, too often those at the top fail, miserably, to share any rewards with the people down on the lower levels. Indeed, whilst the pay of CEOs and other directors have continued to increase apace the same cannot be said for people on the average wage and lower. In fact, pay increases for the lower levels have tended to remain at or below the rate of inflation thus increasing the gap between the rich and the poor. It is time for equity in pay rises and access to share options.

Besides, companies which tend to pay their CEO and directors excessively, that is a basic salary greater than say 15 - 20 times the lowest paid employee, run the very real risk of not only alienating them, workers, but also run the real risk of alienating shareholders the moment the company performance falters. Fraud and corruption, in financial matters, do exist and because it is not seen by the media and the public it could be referred to as victimless crime. But there is not such thing as victimless crime, and in the case of financial crime it often affects hundreds if not thousands who lose their money or savings. That is why government must act and must be seen to act if white-collar crime is to be deterred if not stamped out, through regulation as necessary.

And that is one of the major problems with any government attempting to hold down wage demands especially in the public sector, the fact that there are senior managers in the US and definitely in UK Plc who are paid in the order of 500 to 600 times, or even a 1000 times, the salary of the lowest paid employee in their organization. Is that really a way to encourage commitment or improve productivity or efficiency? Is it really showing leadership by having access to company jets and helicopters, company houses and flats and access to private clubs? Large pay packets, generous share options and excessive bonuses cannot be defended when the gap between the pay and conditions of those at the top and ordinary employees has widened over the past two decades.

Furthermore, when directors are seen to receive such excessive remuneration they will face resistance to change and even antagonism. If they pursue aggressive programmes of cost reductions, downsizing and delayering that lead to major redundancy programmes the level of antagonism can result in negative external relations and have a negative impact on shareholder value.

Shareholders are likely to be even less amused when the company in which they have invested fails to perform under the leadership of the Chairman and Chief Executive leading to the departure of these senior directors with handsome leaving packages - no doubt negotiated on appointment, just in case. The question must be what, if anything, are they or could they do to rein in the annual pay hike and more especially when it runs into hundreds of thousands and sometimes millions of pounds?

Can companies, Chief Executives, Managing Directors and boards not see that the continuing surfeit of greed in the City is actually increasing the level of frustration among the ordinary shareholding public and the country at large and that pay differentials between top and bottom have really got out of all control? And, can they not also see that that frustration is a source of de-motivation, dissatisfaction and discontent? It really is time to rein in the anti-social aspects of greed at the top of companies.

Shareholder Interest

We are also advised that remuneration committees, consisting of executive and non-executive directors, set pay levels for directors and senior managers and that these proposals are accepted and agreed by shareholders. Since when have shareholders, that is apart from the major city pension fund managers, ever been advised of proposed pay increases and asked to vote on directors salaries let alone other perks? Frankly, the reason for the growing excesses is the fact that shareholders are, generally, complacent about the company, its senior managers and its performance until it is, often, too late. Company Annual General Meetings (AGMs) tend to be low-key, low attendance affairs. Unless there is an unusual feature like a potential merger, a large-scale acquisition or a new issue in the offing many an AGM could be conducted in the boardroom.

A dismal attendance and voting record at Annual General Meetings (AGMs) indicates a degree of complacency (or is it satisfaction?) among individual investors and individual fund managers, and a desire, perhaps, not to 'rock the boat'. In the UK it is estimated that only some 30-40 per cent of fund managers bother to vote but in the US more like 80 – 85 per cent vote on issues affecting corporate governance and the management of companies. Therefore, I suggest that one set of villains in the piece are fund managers because they invest monies from, for example, pension funds and they are chasing the highest return in the shortest time to increase their own bonuses and purchase the chateau, Porsche, Ferrari, Daimler and yacht that so many appear to have.

And, rather than voting on a 'show of hands' or a postal vote why are procedures not in place to allow shareholders to vote by electronic means - telephone, facsimile, e-mail or even via the internet? It is now beyond time that investors, and I include institutional investors who represent pension funds and the like, took a much closer look at levels of remuneration and termination agreements. Or is this yet another cosy cartel, between senior management and fund managers, where the latter supports the former provided they receive their bi-annual dividend, which ensures they get large salaries and bonuses?

Non-Executive Directors

One of the key areas of responsibility of non-executive directors is to monitor the performance and behaviour of the executive directors. They play a particularly important role in matters of remuneration for the executive directors, normally exercising their power though a remuneration committee.

The impartiality of non-executive directors is increasingly being questioned. Recent research, in 1997, published by the financial monitoring group Company Reporting suggests that large numbers of non-executive directors, whose job it is to represent the interests of shareholders in the boardroom, are, perhaps, not as independent as the system, and society, would wish. There is also a suggestion that too many chief executives and other directors sit on the boards of companies of colleagues and chums and this has created an incestuous situation where they each recommend and support one another's pay rises.

It is understood that a relatively small group of people sit on the remuneration committees of many large and publicly quoted companies in UK Plc whilst they also have other executive or non-executive directorships in other organizations. These people are, in effect, controlling the whole system of pay and reward processes for top executive directors and suggests, allegedly, that relationships at the higher levels are, again, incestuous.

There are clear dangers in this arrangement. It could lead to systematic pressure on and from this group to constantly increase the salary and perks of friends so that they can retain their clutch of directorships. However, if they act with integrity, professionalism and transparency their widespread experience of the employment market for senior directors will enable them to benchmark performance and to resist unreasonable claims by executive directors.

Some PLC boards are criticised for their tendency to recruit former politicians and others whose sole credentials appear to be social status rather than knowledge of the business, market knowledge or relevant technical expertise. Some companies, allegedly, deliberately choose to recruit non-executive directors from their own bankers, lawyers, city financial institutions and other companies with whom they do business. These relationships can work to the benefit of investors but they can become too incestuous. It is a matter of balance in the boardroom and a challenge to the whole process of recruiting non-executive directors.

What needs to happen is that companies should determine the type of experience and expertise essential to provide a balanced flow of information to assist Chairman and Chief Executives to determine strategy and direction. Governance is an important area for business but then so are, for example:

a. Knowledge and relevant experience of core business area.
b. General management ability in systems, procedures and processes.
c. Understanding of IT and IT systems and how they can help the business.
d. Marketing skills and contact with appropriate organizations.
e. Understanding and appreciation of the need for training.
f. Business contacts.

Auditors

Auditors, by that I mean the major firms of accountants who normally have the contract, of publicly owned companies owe a duty of care to individual shareholders to exercise reasonable care in carrying out audits. An audit of a company is an audit of the work of the whole board of directors – collectively. The senior partners of accountants/auditors often undertake advisory or consultancy work for senior directors and can become too close to those directors and the result can be ‘blindness’ to the failings or shortcomings in an organization, its internal procedures and its accounting practices.

Under those circumstances auditors could, perhaps, be failing their clients, the shareholders, by not conducting more thorough investigations. ‘Chinese walls’ are often claimed to exist in such firms – communication barriers to inhibit such problems and conflicts of interest. If these organizational devices were effective the likes of the Barlow Clowes affair, Maxwell Pension Fund, BCCI or Barings Bank disaster might not have happened. And, yet other organizations might not have wasted company profits on hostile bids, mergers and acquisitions. Cosy relationships between the two, accountants and boards, must be discouraged.

Way Ahead

There are now many supposed ‘best business practice guidelines and all quoted companies need to follow the examples of the best. So, I suggest it is time for the Annual Report of all quoted companies to provide full details of the remuneration package of each director and include individual totals including share options, bonus packages and contributions to individual pension schemes. Shareholders would then be able to make a more balanced assessment of the performance of directors and their remuneration packages.

Given the, apparent, importance of corporate governance Chairmen, Chief Executives, Managing Directors and Directors of publicly quoted companies must accept the concepts of responsibility and accountability. Accountability, that is, to all shareholders, not just those with the greatest number of shares, fund managers and other financial institutions but also to those with a small number of shares. In that vein it is time that all director’s contracts were established for 12 months or less and also that they be subject to re-appointment on an annual basis at shareholder meetings at which electronic voting on remuneration and other major issues would have to be accepted.

Why, when so much importance is placed on teamwork and widely accepted that the ability, effort and commitment of every worker in an organization is essential, do only those at the very top of an organization benefit from bonuses and share options? If it is recognized that teamwork is essential in any organization then why are members of teams not rewarded the same in order to maintain the concept of teamwork?

One major challenge for all companies now and in the future will be to retain staff. How should staff respond when they see huge pay rises for directors and senior managers when they receive minor percentage increments in their annual pay package? Do senior managers not think their attitude is a demotivating factor? Surely unfairness perceived or otherwise, is unlikely to enamour any employee with an ounce of nous and initiative?

Why do directors of companies recognize that they need economic stability to plan, invest and generally finance future business but do not apply the same principles to the economic stability of their employees? Besides, employees are not rewarded if and when they are removed by downsizing or delayering programmes or if they have failed to perform what was required of them so why continue to reward directors, with huge salaries, share options, pension contributions and ‘golden goodbyes’ for having failed to perform?

Why, when senior management has insisted on the introduction and implementation of performance-related pay schemes for all employees below a certain level are those same schemes not introduced for all Chairmen, Chief Executives and other directors? Indeed, if, as many senior managers say, companies are managed to provide the best return for shareholders then why not tie any bonuses for senior managers to the overall performance of the company and its share price over a longer period of time and not just 6 or 12 months?

Why don’t companies introduce employee share ownership (ESOP) schemes and offer employees the option of purchasing shares at the same generous discounts as directors when it has been proven time and time again that companies with such schemes tend to be more productive and efficient based on the premise that a financially involved workforce will, necessarily, have much greater interest and commitment to company success. Clearly what is sauce for the goose is not sauce for the gander and the rule of do what I say and not what I do appears to apply!

No doubt companies, by that I mean directors, will continue to insist that there are too many guidelines and that self-regulation is the only way to proceed because their organizations are publicly owned and governance is exercised by the City and the share price. Also, it appears that the boards of too many companies consist of other chief executives, managing directors and directors from other companies all who have a vested interest in maintaining the ‘status quo’ and the indefensible high levels of remuneration and share options.

Therefore, shareholders must vote on the remuneration package of chairman, chief executives, managing directors and directors to ensure that such options as ‘golden hellos’, ‘golden goodbyes’ and ‘golden parachutes’ do not form part of a remuneration package and that loss of office means no more than 3, 6 or at the most 12 months basic salary.

But, these people are running companies and organizations that employ the people of this country and they are making and taking decisions that affect the lives and the livelihoods of hundreds and in some cases many thousands. The fact is that successive governments have not and do not police capitalism and businessmen are not prosecuted enough for perpetrating fraud. The propensity for greed among directors and senior managers appears to be on the increase and it is encouraged by the annual share options lottery, which encourages the pursuit of short-term profit at the expense of longer-term investment and sustainability of companies.

To deal with the short-termist approach chairmen, chief executives, managing directors and directors should not be allowed over-generous share-option packages because shares are owned by the shareholders and they are the ones should agree and approve any allowances.

What needs to happen, perhaps, is for much greater effort to be made at detecting and catching those responsible for large-scale white-collar crime and for the system to ensure that they are given lengthy sentences for the fundamental reason that they tend to be people of greater academic or professional knowledge and ability, they have been given access to greater privileges and their actions can and do affect the livelihoods of hundreds or even thousands and maybe even committing many them to the increased possibility of poverty.

Without the deterrence of custodial sentences, and very heavy personal fines, it seems unlikely that corporate greed will be nipped in the bud and it is very unlikely that the general public will have any respect for the legal system, big business and politicians. Why politicians, because they are the ones who are squeezing the bottom and middle but have allowed, over the last few decades, the removal of any restraints on the pay and perks and other bonuses paid to the most senior directors in UK Plc, and have even encouraged the growth of greed by allowing for tax loopholes and off-shore bank accounts and not introducing tighter rules in income taxation for the highest paid.

In a related area, some, if not many, appear to be paid large sums of money, in cash handouts, share options and large sums to personal pension plans, for gross incompetence. This has to change, indeed this must change and directors should not be reimbursed for failing if for no other reason than that it places additional burdens on budgets that are hard pressed when companies fail. And, it has to change because the gap between the rich and the poor is increasing and is also leading to a breakdown in society through the increased loss of social, moral and ethical values that were once part of the fabric of the Christian society of Britain

Talk is cheap and words are even cheaper unless they form part of legislation that is designed to stamp out corruption and malpractice and enforce transparency in accounting principles and management practices. Perhaps some time in the near future shareholders, individuals and pension fund managers, will adopt a more skeptical approach to CEOs and other senior executives over their pay packets and share options? If they do not then I fear that the public, small shareholders and even pension fund managers might become increasingly cynical.

Is it too much to expect a degree of integrity, social responsibility and accountability when it comes to pay and perks? Is it too much to ask for a degree of leadership and direction from politicians and senior business figures in an effort to restore a level of sanity and social concern in what has become a morally bankrupt nation with failing public services and more especially in health and the provision of social services? Is it really too much to expect that those at the middle or the bottom will receive a pay increase at the same rate as those at the very highest levels, or perhaps more because they are starting from a much lower base? Is it too much to ask that the personal allowance be increased to take more of the poorer paid people out of poverty and the tax trap of direct and indirect taxation? As Franklin Delano Roosevelt suggested, when referring to the progress a nation makes in improving the lot of its citizens,

> "The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little."

(Franklin D Roosevelt (1882 – 1945), 32nd President of the United States)

Self-regulation, in just about every area of business, has not made an iota of difference, indeed it is almost as if government has given a green light to those running companies and organizations to indulge in a feeding frenzy to the level where thousands are paid in millions when there employees have received little or no pay increases because of the political desire to ‘hold down’ inflation. Why is it that grossly inflated salaries and bonuses for those at the top do not affect inflation but pay increases of less than 3% apparently have a considerable effect on the national level of inflation? What game are politicians, and the treasury, playing at?

What is required is action and the introduction of even stricter regulation, perhaps even legislation, to ensure that ‘fat cats’ do not get even fatter, and, that it is made very clear that directors and boards are both responsible and accountable for the financial state of the companies they serve. And, more importantly, for any proposed governance, guideline or even legislation to be properly policed.

(4740 words including quotations)

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1998