Executive Pay: the Government's blind eye

by John Hunter

Peter Parry reports elsewhere on the disappointingly tepid outcome to the government's consultation on corporate governance reform. From the point of view of UKSA's parochial interests the complete lack of progress on 'ownerless corporations' is the most disappointing. But the question of executive pay has more general significance for the public.

We are social animals as well as economic ones. The widening pay gap between the rich and the poor is beginning to inflict social damage. The 'runaway remuneration train' – to borrow the phrase of a prominent FT columnist – is a major factor. Government should lead, but in its executive pay proposals has spectacularly failed to do so. In the words of the same columnist: 'The proposal to hang out a few flags in the hope they will slow [the train] is risible.'

This article is my attempt, on behalf of UKSA members, to fight for something better.

Let me remind you of the way senior executive pay is set. A remuneration consultant is retained, paid for by the company, his appointment heavily influenced by the executives concerned. The consultant makes a report to the remuneration committee of sufficient complexity (that's what he's paid for) to confuse the committee, which is anyway composed of other passengers on the runaway train. The pay structure recommended will not show any evidence of knowledge of the academic research into effective incentives. The committee produces a 20-page remuneration report for the shareholders - according to governance guidelines and therefore impenetrable.

The shareholders – predominately conflicted intermediaries such as fund and nominee account managers – vote each year on the report (not on the awards specifically, just the report on the awards). This vote is non-binding, therefore useless. However, every three years shareholders have a binding vote on the remuneration *policy* (i.e. not the actual pay). This will have been written by lawyers and will take three pages to say that everyone is paid extremely carefully with lots of oversight, lots of external comparisons and lots of attention to special interests who would otherwise complain (environmental, social, employees). If it fails to pass at AGM the lawyers will be fired and a new set employed to write a better policy statement. It will take another three years for them to be fired, if necessary. The effect on actual pay? Zero.

In short, executives set their own pay. And it corrupts honest and talented men and women (because that's what most executives are) into believing they are worth the ridiculous amounts that emerge once compound interest has done its work. The process is one of which Jacob Zuma would be proud; and diminishes respect for executives, both individually and as a class.

And there's an easy solution (well, not actually a solution but an essential first step). That is for senior executive remuneration contracts, and any discretionary awards under those contracts, to be approved by shareholders. The reason this perfectly obvious measure has not been taken is that government will have been under enormous lobbying pressure to retain the status quo. In particular they will have been advised that it is 'impossible' (I have seen the word used). Well, I had a career in the corporate world and I can tell you that getting these sorts of things done in a quoted company is an everyday skill. Any company secretary who suggested that this was 'impossible' would quite rightly be fired.

Distance lends perspective. UKSA was formed in the early 90s on the back of public outrage at the pay increases of utility company chairmen following privatisation – the argument being that able, even outstanding, civil servants had been magically transformed into corporate titans. In the case of Cedric Brown, Chairman of British Gas and poster man for this movement, this meant an increase from £275,000 to £475,000. These would be £450,000 and £800,000 in today's money. The average FTSE100 CEO today makes £5m. The CEO of Centrica (successor to British Gas) made £4.2m in 2016. Now, whatever the merits of these gentlemen, it is hard to believe that the economic imperatives have altered enough in the last 25 years to justify a 5-10 times multiplier (depending on which starting number you think is reasonable) in what they are worth.

One has some sympathy with the government – caught as it is in the headlights of another runaway train, the Brexit negotiations – and therefore unwilling to make any move in any direction on any other issue. But its insouciant lack of attention to this pressing social issue is shameful.

An appreciation of Bill and Kateřina Johnston

by Charles Breese

Bill Johnston and I met around 2000, a time when the dot com bubble had burst. The cause of our meeting was that we had independently realised that the internet could be harnessed to significantly improve the flow of data to private investors, thereby assisting the levelling of the playing field as between private and institutional investors. We had each set up a website covering the Alternative Investment Market (AIM) because we both realised that wealth creation starts with smallcaps and, because of capital market inefficiency in relation to smallcaps, AIM provides an exceptional opportunity for the well-informed private investor to make above-average returns.

Bill and I came at investing from complementary standpoints inasmuch as I am a very long-term investor whilst Bill enjoyed commenting on companies but didn't actually invest. What he brought to his commentary was a very dour Scottish eye able to look through the superficiality which pervades so many AIM companies. In addition, he wrote in a pithy and entertaining manner which, I am sure, many TPI readers will have enjoyed over the years!

Bill has enormous intellectual energy, evidenced not only in his prodigious output of company commentaries but also in his remarkable perception of how to use the internet to provide a time-efficient tool to enable investors to quickly scour his website to find companies of the profile which they were targeting by introducing a Company Grading Key. This facility continues to be available on my website (www.smartcoresearch.com) today; its benefit with regard to my Investment Template is that it cuts down the AIM universe of c.1,000 companies to around 60 companies. The imagination required of Bill to envision this and then to implement it was remarkable.

When Bill was looking for additional editorial work, I had no hesitation in introducing him to UKSA to edit TPI. This role also illustrated the wonders of the internet, because he was able to continue doing this role, with valuable support from his wife Kateřina, even after he moved to Czechoslovakia.

Editor's note: readers who would like to be registered to use the site should e-mail Charles Breese at charles.breese@larpentnewton.com.