Event Report: ‘Market or Racket: do we need a new approach to executive pay?’

Panel: The Commercial Realities of Pay

Moderator: Phillippa O’Connor, Partner at PwC
Panellist: Nicki Demby, Partner at Stork & May
Panellist: Alan Giles, Chairman of the Remuneration Consultants Group
Panellist: Emma Watford, Partner at Bridgepoint

Phillippa O’Connor, Partner at PwC led a practitioner discussion examining the commercial realities of pay. She was joined on the panel by Nicki Demby, Partner at Stork & May, Alan Giles, Chairman of the Remuneration Consultants Group and Emma Watford, Partner at Bridgepoint.

O’Connor opened the session by asking about motivation and whether pay really matters in the context of recruitment. Demby said that only a small number of people are truly and exclusively motivated by pay, people she refers to as “coin operated.” She said that in her experience, working exclusively with senior level executives, most people are more interested in intellectual challenges and the opportunity to solve business problems. For Demby, it is “quite unusual that pay is the absolute driving force.” Watford said that in the private equity world many hold a belief that they could be better remunerated working outside the private markets, so often assume they will be taking a pay cut. She said that private equity executives tend to be particularly focused on whether they have sufficient upside rather than the base level of pay. Watford also said that privately owned businesses are more flexible in terms of remuneration and are better able to tailor packages to what motivates the executive.

The panel discussed the personal characteristics required to lead a firm and how these feed into pay negotiations. Giles argued that if you want a CEO that has strong negotiation skills that will benefit the firm, then you must expect the executive to negotiate well in their own pay discussions. He also said that top executives are “innately competitive” and think of themselves as top performers. He made the point that more transparency and disclosure on pay also brings downsides and can help to drive up pay. Not many people think of themselves as being below average, and not many remuneration committees think their executives are below average, so it follows that they would not approve of below average compensation.

Drawing on the expertise of the panel, the difficulties for executives working in the public markets versus private markets were highlighted. Public companies face an enormous amount of scrutiny which adds an extra layer of complexity to the roles of CEOs, board directors and non-executive directors. Giles shared his experience working as a remuneration committee chair for public companies. He called it “arguably the toughest job in the boardroom” which requires a difficult balancing act between shareholder, public, political and media pressure. Watford shared anecdotal experience of the challenges that non-executive directors face working for UK public limited companies. She mentioned how a number of people she had encountered said they would not take on a PLC role again. Watford said that one person in particular told her that there was too much scrutiny in the public sector compared to the private equity environment. Demby also discussed the pressures on base salaries in public markets. She illustrated how institutions have been effective in keeping base salaries from ratcheting upwards in recent years.

The panellists discussed how public and private businesses, at various stages of development, or undergoing diverse challenges or growth, have different needs for executive leadership. Demby said that the UK currently has a “one size fits all” pay model and questioned whether this is fit for purpose for different business needs. She said that the pay model should vary depending on the
problem that is trying to be solved. Giles echoed this line of thought and said that it is very difficult to have a one size fits all remuneration policy when each company works in different sectors, with different strategies, and with different factors outside of the company’s control such as the economy or regulatory position. He said that this makes conventional long-term incentive programmes very difficult to manage, as it is hard to judge the likelihood of windfall gains and said that he favours restricted shares.

Demby expressed concern that growing restrictions around executive pay in the public markets could have an impact on competitiveness from an international perspective. Demby said that many people think pay is out of control in the UK. However, she is more concerned about whether under growing restrictions on executive pay, the UK can still attract the best people to come and do business. She said, “we’ve got to be very thoughtful not to kill that golden goose because it’s a fabulous place to do business.” Demby indicated that there should be a balanced debate about the pay of senior executives. Giles emphasised the importance of an effective flow of information between shareholders, companies, management and remuneration consultants on executive pay.

Speaking from the audience, Alex Edmans asked the panel about the objective of boards when they set pay: to choose the right CEO to maximise long term shareholder value and decide how much to pay her, to choose a pay range to avoid the outrage constraint and the best CEO that fits that range, or to avoid scandal by not making any controversial decisions. Watford said she believes boards largely prioritise the right CEO and then work out how much they would have to pay them. She noted that CEOs with huge compensation packages would generally have been screened out beforehand. Giles said there is normally a precedent of what the current or previous CEO is earning, which brings reasonable limitations. He stressed the importance of having an open dialogue with shareholders on a weighted average optimum solution. Demby agreed with Watford and said finding the right CEO comes first, but that some candidates would have been filtered out beforehand as they were unaffordable. In terms of avoiding a scandal, Demby said this was a difficult question and involved a broader debate between the whole board. She said candidates would be considering all these elements themselves, and particularly if they were aiming for a chairperson role in the future, would not want to carry the stigma of any corporate governance problems into the rest of their careers.

The panel was divided on the element of luck. For instance, sometimes poorly performing CEOs are rewarded when their companies’ stock price rises due to good macroeconomic conditions. Giles said that this issue keeps him awake at night and said as a remuneration committee chair, he would want to avoid schemes where people are inadvertently rewarded for poor performance. Demby said that this was not an issue that particularly worried her. She felt that there is an element of good luck in all business decision making and “the best thing you want is a general who is lucky.”