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Executive remuneration: the power and dominance of human greed

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Introduction

The constant making and revision of laws and recommendations on executive remuneration tend to suggest that there is a 'bigger' cause to the problem than a simple luxurious pay package. This 'bigger' cause is called human greed. Posner explains human greed as 'man as a result of living in a world of limited resources, is a rational self-maximizer, i.e. he always aims to maximise his satisfaction and self-interest which is essentially greed.'¹ Greed can be further explained by referring to the Oxford English Dictionary defining greed as 'the intense and selfish desire for something, especially wealth, power, or food.' The executives occupy one of the most important positions in a company because they act on behalf of the company by making crucial decisions on a day-to-day basis. This position of an executive in the company presents potentials for conflict of interest which, if not well properly managed, it could be a vehicle for greed to ride on. Executive remuneration is part of the corporation's culture where the management (board of directors) decides how much to pay the executives in accordance with the company's articles of association and policies. This position presents the executives with potential to desire/acquire more wealth and power for themselves than for the company interest, which generally could be as a result of human greed. Too much executive remuneration has been in the spotlight since the early 1990s because of its lack of link between executive directors pay and company performance; and the widening pay gap between the executives and ranked profile employees. This paper argues that without the presence of human greed, executives would make reasonable pay deals without the involvement of the government. Therefore, to regulate executive remuneration effectively, policymakers should make laws that will limit or eliminate the vehicles of human greed.

Policy-makers have long demonstrated their reluctance in interfering in the internal affairs of the company to uphold the corporate form as a separate legal entity with rights and liabilities.² This reluctance by policymakers effectively means that executive pay is being determined by the board of management on which the executive sit. This opens up great potentials for conflict of interest and also providing a vehicle for human greed which could manifest in the process of determining executive remuneration and consequently reflect on the executive pay levels.

¹ Posner R. Economic Analysis of Law (NY, 2011, 4thedn.) chapters 1 & 2.

² Salomon v Salomon [1896] UKHL 1.

This article will argue that executive remuneration cannot be effectively regulated so long as the executives still occupy the position that they have in the company and the management of the company still solely in the hands of the board of management. This article will proceed to identify and discuss the presence and manifestation of greed in the executive pay determination process and the pay levels. This paper will first, examine the origin of the executive remuneration problem and discuss the role played by human greed. Secondly, the paper will also examine the ineffectiveness of the current regulatory mechanisms that brings out the presence/role of human greed. Third, the paper will discuss some evidences of greed as they are being perceived by the public, shareholders, academics and stakeholders. The paper will conclude by discussing the way forward on whether executive remuneration driven by greed can be regulated.

Greed: The genesis of excessive executive's remuneration

Executive's remuneration became a contentious issue of corporate governance in the UK after the privatisation of some utility companies in the UK in the early 1990. The privatisation process was a market liberalisation procedure to encourage the economy of the UK to recover after World War II. Through the liberalisation of the market, the government also wanted to encourage private entities to participate in the economic development of the country. Consequently, the government removed its regulations and restrictions on businesses leaving its governance in the hands of the management of the companies. The liberalisation of the market, created great potentials for conflict of interest because the executives could determine their own pay. This opportunity was quickly taken over by human greed and its manifestation was almost immediately evident in the pay package of the then British Gas chief executive director. In the words of Engmann, greed can be described as one of the deadly sins of a man and it can be manifest in different ways such as greed for life, money, power, knowledge, etc.³ The executives used the power and the position bestowed upon them by the company to acquire more for their own benefits and also to acquired more money for themselves. The privatisation of British Gas in the early 1990s saw the pay of the then executive director, Mr. Cedric Brown's pay soar over 300% of his pay before privatisation. This pay increase could not be justified on company performance, but the more realistic justification for Mr Browns' behaviour would be human greed. Considering that the state had (and still are) reluctant to interfere in the internal

³ Michael Engmann, *Greed is Good Big is Bad* (Xlibris Corporation, 2014) 13.

affairs of the businesses, greed pushed Mr Brown not just to award himself enough, but much more than what would have been expected from a reasonable man. Even though, Mr Brown's pay was highly criticised, and Mr Brown called to justify his pay in the house of parliament, it did not stop the wave of freedom that human greediness had found. Since then, the growth in executive pay has continued to increase and it has been criticised by media⁴, academics⁵, shareholders⁶, government⁷, etc., but yet, the pay growth has not stalled or decreased. Greed could make the executives to focus more on their interest rather than the interest of the company, shareholders, stakeholders and/or the society as a whole. A survey carried out by the Institute of Chartered Secretaries and Administrators (ICSA)⁸ showed that there is a growing anecdotal evidence that executives do not understand their exotic packages. This is a clear evidence of greed because greed does not allow the person to be objective and analytical. Earlier academic researchers had identified the presence of this human greed, but addressed it in other terms such as the agency theory' or 'the agency problem'.⁹The agency problem in this context is the conflicts of interest that exist in the relationship between the executives and the company. The executives are expected to act in ways that will promote the success of the company, but because of their potential conflicts of interest that has served as a vehicle for human greed, the executive have been found to act more in their best interest.¹⁰ Executive remuneration has been researched and many discussions has been centered on this agency problem¹¹, rather than addressing the underlying problem of the agency problem which is human greed.

The effect of Greed on the regulation of executive remuneration

⁴ 'Fat Cats in the Dock' (1995) Economist March 4th.

⁵Bolton P, Mehran H and Shapiro J, 'Executive Compensation and Risk Taking' (2015) 19(6) Rev Financ 2139-2181.

⁶Macalister T, Treanor J and Farrell S, 'BP Shareholders revolt against CEO's £14m Pay Package' (2016) The Guardian, April 14th.

⁷ Case Study: The Case of British Gas (1996) 4(1) Corp. Gov. Inter. Rev. 21, 22; Swinford S., 'Theresa May unveils crackdown on executive pay and announces new plans to protect pensions' (2016) The Telegraph, November 29th.

⁸ Company Lawyer, 'Executive Remuneration needs a Rethink according to ICSA Survey' (2016) 37(9) Comp. Law. 282-283

⁹Bebchuk L and Fried J, 'Executive Compensation as an Agency Problem' (2003) 17(3) The Journal of Economic Perspective 71-92; Conyon M, 'Executive Compensation and Incentives' (2006) 20(1) The Academy of Management Perspective 25-44; Townsend R. and Shue K., 'Growth through rigidity: An explanation for the Rise in CEO pay' (2017) 123(1) Journal of Financial Economics 1-21.

¹⁰ Bebchuk L and Fried J, 'Executive Compensation as an Agency Problem' (2003) 17(3) The Journal of Economic Perspective 71-92.

¹¹ Bertrand M and Mullainathan S, 'Are CEOs Rewarded for Luck? The Ones Without Principals Are' (2001) 116(3) Quarterly Journal of Economics 901-932.

Pay disclosure

In the early 1990s, there is a very little required by the companies in terms of disclosure. There was very little transparency and accountabilities in how the executive remuneration was being determined. This lack of transparency and accountability presented itself as the perfect vehicle for greed to ride on. Executives were able to enrich themselves as much as they could because they were not obliged to explain themselves to the shareholders/public/media for what they were doing. Although they had the shareholders to answer to in the annual general meeting, the shareholders had no resources to base their arguments on. The result of this was the continuous rise in the levels of remuneration, complexity of the pay package and pay gap between the executives and the workers.¹² In 2002, companies were required to produce a Directors' Remuneration Report which contained information on the process of determining executive remuneration.¹³ This report was subject to shareholder advisory vote at the annual general meeting.¹⁴ Academics at the time,¹⁵ argued that the disclosure requirement and the shareholder vote on the remuneration report were not adequate to curb excessive executive remuneration. Even though some academic research demonstrated some improvement in pay-performance sensitivity as a result of the disclosure rules¹⁶, the financial crisis of 2008 revived the debate over excessive executive remuneration. In 2013, more enhanced disclosure rules were enacted by the government on executive remuneration.¹⁷ Research has demonstrated that the disclosure requirements is yet to improved the link between executive pay and the company performance or has it closed up the gap between executive pay and rank profile employee pay.¹⁸ Gupta *et al.*¹⁹ argued in their research that companies were using the disclosure

¹² Murphy K, 'Executive Compensation: Where we are, and How we Got There' (2012) Marshall School of Business Working Paper (FBE 7.12) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2041679 accessed on the 4th of May 2017.

¹³ The Directors' Remuneration Report Regulation 2002 (SI 2002 1986) which inserted the new s243B into the then Companies Act 1985.

¹⁴ S241A of the then Companies Act 1985

¹⁵ Roach L, 'The Directors' Remuneration Report Regulation 2002 and the disclosure of executive remuneration' (2004) 25(5) Comp. Law. 141-148.

¹⁶ Ferri F and Maber D, 'Say on pay votes and CEO compensation: evidence from the UK' (2013) 17(2) Review of Finance 527-563.

¹⁷ Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendments) Regulations 2013.

¹⁸ Gupta A, Chu J and Ge X, 'Form Over Substance? An Investigation of Recent Remuneration Disclosure Changes in the UK' (2016) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2798001 accessed 4th May 2017; Gordon S, 'UK disclosure rules tying CEO pay and performance not working' (2016) Financial Times, June 27th.

¹⁹ Gupta A, Chu J and Ge X, 'Form Over Substance? An investigation of Recent Remuneration Disclosure Changes in the UK' (2016) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2798001 accessed 4th May 2017

requirement only to manage their reputation, and many companies reported only on certain geographical locations or certain types of workers. These research findings demonstrates the fact that the executives have great potentials and power to act in the ways that will benefit them, and these potentials are being greatly exploited by human greed resulting in the ineffectiveness of the aims of the disclosure requirement.

Executive directors' disclosure requirement has been considered a contributory factor to the increasing levels of executive pay levels.²⁰ This disclosure enhances the access to market comparator information on executive remuneration in which the executive and the board can use to strengthen executive's bargaining power.²¹ This availability of information on pay levels increases the expectation and negotiation stance for the executives, and this as well give greed another vehicle to ride on. Executive pay disclosure rules have not only failed to achieved the intended aims of curbing excessive remuneration but it also has unintended consequences of pushing executive pay levels up by giving human greed more opportunities to manifest.²² Through the disclosure of executive remuneration, the shareholders, the public, the media and stakeholders etc., have realised the excessive executive remuneration except the executives themselves. This can only have one justification which is human greed. Ms Theresa May (the Britain's Prime Minister) proposed plans to compel companies to disclose the ratio of the CEO's pay to that of the average employee.²³ Given the ineffectiveness of the disclosure of executive remuneration package, it is difficult to see how the disclosure of the pay ratio differences would have had an impact on executive pay levels. After she Realising that these plan may not be the best move to curb executive excessive pay, the proposals were abandoned.²⁴

Shareholder Say on pay

The Companies Act 2006 has given the shareholders the power through voting to monitor and hopefully curb excessive executives' remuneration. The advocates of shareholder pay on pay

²⁰ Edward Iacobucci, "The Effects of Disclosure on Executive Compensation" (1998) 48(4) U. Tor. L.J. 489, 503.

²¹ Iacobucci, 'The Effects of Disclosure on Executive Compensation' (1998) 48(4) U. Tor. L.J. 489.

²² Schoenberger C, 'How More Pay Disclosure has Pushed up Executive Compensation' (2016) available <http://review.chicagobooth.edu/accounting/2016/article/how-more-pay-disclosure-has-pushed-executive-compensation> accessed on the 4th of May 2017.

²³ O'Connor S, Oakley D and Parker G, 'Theresa May's plan to expose boss-employee pay gap flawed' (2016) Financial Times, September 22nd.

²⁴ Pickard J and Gordon S, 'May waters down plans for binding votes on executive pay' (2016) Financial Times November 29th.

advanced, the fact that say on pay will enhance accountability and transparency in the determination process of executive remuneration through shareholder voting.²⁵ However, this has not made any significant difference to the rate of growth of executives' remuneration. Shareholder say on pay was advocated since 2002, but there has not been any significant change in executives' remuneration levels as a result of shareholder activism. Shareholders have demonstrated the unwillingness to use the powers vested upon them by abstaining from resolutions on directors' remuneration in the annual general meeting.²⁶ One of the reasons is the challenges faced with the nature of the disclosure and the information disclosed. The shareholders are unable to understand the information or don't pay attention to the details provided and consequently are unable to fully make an informed decision on executives' remuneration.²⁷ Main and Johnson²⁸ stated that *'The complexities of present-day remuneration packages demand a degree of expert knowledge and specialised information. If pay is to be linked to performance, then it seems wise to give some attention to this details, and it also seems wise that the dominant perspective on such matters comes from those who most obviously represent the shareholders, i.e. the board and the non-executive in particular.'* Main and Johnson, therefore, recognised that the shareholders may not be in the best position to monitor and curb excessive executive's remuneration and therefore, there is a need for the experts (who are the remuneration committee) and the board to act on behalf of the shareholders. Considering that the remuneration committee and remuneration consultants are not completely independent from the board of executives, they are therefore incapable of safeguarding the interest of the shareholders.²⁹ Shareholders' ability to effectively monitor and curb excessive executive remuneration may be effected by the fear that large dissent vote could diminish the market value of the company.³⁰ This, therefore, means that shareholders may not use their power to

²⁵ Gregory I, Thompson S and Wright P, 'CEO Pay and Voting Dissent Before and After the Crisis' (2014) 124(574) *The Economic Journal* F22-F39

²⁶ Gregory-Smith I and Main BGM, 'Binding Votes on Executive Remuneration' (2013) available online http://webmeets.com/files/papers/res/2014/745/v2013_10_03.pdf accessed on the 9th of May 2017.

²⁷ Germer-Beuerle C. and Kirchmaier T., 'Say on Pay: Do Shareholders Care?' (2016) FMG Discussion Paper DP751, Available https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2720481 accessed on the 4th of May 2017.

²⁸ BGM Main and Johnson J, 'Remuneration Committee and Corporate Governance' (1993) 23(1) *A & BR* 351, 352

²⁹ Conyon M & Peck S 'Board Control, Remuneration Committees, and Top Management Compensation' (1998) 41(2) *Academy of Management Journal* 146-157; Conyon M, Peck S, Read L, & Sadler G, 'Compensation Consultants and Executive Pay: Evidence from the United States and the United Kingdom' (2009) 23 *Academy of Management Perspectives* 43-55; Conyon M, Peck S, Read L, & Sadler G, 'New Perspectives on the Governance of Executive Compensation: Examining the Role and Effect of Compensation Consultants' (2011) 15 *Journal of Management and Governance* 29-58.

³⁰ Gregory-Smith I and Main BGM, 'Binding Votes on Executive Remuneration' (2013) available online http://webmeets.com/files/papers/res/2014/745/v2013_10_03.pdf accessed on the 9th of May 2017.

vote against the remuneration report or simply abstain from voting, consequently having no effect on executive remuneration levels. However, say on pay has given shareholders the opportunity to voice their dissatisfaction which can be observed through the substantial increase in levels of dissent votes even though, very weak moderation of executive remuneration can be evidenced.³¹

The research conducted in this area has been very scanty, but the common theme arising from the different findings is the fact that shareholder say on pay has not curbed excessive executive remuneration.³² Shareholder say on pay is one of the mechanisms used with the hope of reducing greed and providing more transparency and accountability in the process of determining executive director's remuneration. It was hoped that formalised say on pay will help the management board to look beyond greed and negotiate a more efficient compensation contract with the executive directors' on behalf of the shareholders. Others³³ argued that directors' may ill-inform the shareholders, which is a demonstration and evidence of greed. However, some impact has been documented by researchers with firms responding to high dissent vote by removing the controversial issues identified.³⁴ Shareholder dissent on say-on-pay is higher in firms where CEO compensation is high or 'excessive', and in firms with poor performance.³⁵ Although some researchers³⁶ have demonstrated that there was little evidence that CEO pay is lower in firms that previously experienced high levels of shareholder dissent, but this did not make any significant impact on curbing excessive executive remuneration. It can be argued that the reason why shareholder say on pay has not been effective in curbing executive excessive pay is simply because of greed. This is because the information primarily required by the shareholder to make an informed decision is prepared by the directors. This give the executives the potentials to disclose the information in the way that will benefit them, and it's a question of whether the information disclose by the executives is adequate for the shareholders to make an informed judgement or not. Furthermore, the key determining factor

³¹Gregory-Smith I, Thompson S and Wright P, 'Say on Pay Before and after the Crisis: UK Utility Companies' (2014) 16(3) Network Industries Quarterly 16-18.

³² Ndzi E, 'UK Shareholder Voting on Directors' remuneration: Has Binding Vote made any Difference?' (2017) 38(5) Comp. Law. 139-149.

³³Such as Bainbridge S, 'Remarks on Say on Pay: An Unjustified Incursion on Director Authority' (2008) UCLA School of Law, Research Paper No. 08-06.

³⁴Ferri F and Maber D, 'Say on Pay Votes and CEO Compensation: Evidence from the UK' (2013) 17 Review of Finance 527-563.

³⁵ Conyon M, 'Shareholder Dissent on Say-on-pay and CEO compensation' (2016) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2748645 accessed on the 4th of May 2017.

³⁶Conyon M and Sadler G, 'Shareholder voting and Directors' Remuneration Report Legislation: Say on Pay in the UK' (2010) 18(4) Corporate Governance: An International Review 296-312; Ferri F and Maber D, 'Say on Pay Votes and CEO Compensation: Evidence from the UK' (2013) 17(2) Rev Financ 527-563.

for the shareholders may be the share price in the market and the dividends that they receive. This point is supported by the study done by Conyon³⁷ who found out that the firms that had superior market performance (shareholder return) were less likely to receive shareholder dissent vote. Executive remuneration has been an issue since the early 1990s and the shareholders are aware of the complexity of the pay package and the payment process, research has demonstrated that the shareholders might not be that interested in the determination of executive remuneration. Gerner-Beuerle and Kirchmaier³⁸ argued that shareholder do not pay attention to the details provided on executive remuneration, they only based their judgment on how to vote on the top-line remuneration figure provided on the single figure remuneration report.

It is obvious that where there are high executive remuneration with no clear explanation or large increases in executive remuneration, shareholder dissent votes will be higher. Therefore, the executives in some cases tend to reduce pay in advance of shareholder voting.³⁹ The shareholders then vote in favour of the remuneration report. This demonstrates the manipulation of the system by the executive to satisfy human greed. There has been some impact of say on pay, such as an increased discussion/conversation between the company and shareholders, but the levels of executive remuneration have not decreased.

Corporate governance mechanisms

The UK Corporate Governance Code recommended the use of remuneration committee to stop the executives from determining their own pay, thereby preventing the instances of conflict of interest on which greed ride.⁴⁰ However, despite the importance of the function of the remuneration committee, several academic researchers have examined the impact of the quality of remuneration committee in determining the level and the structure of executive pay and their findings has suggested that the remuneration committee are not completely independent from the executive, meaning the executives still have a role to play in the determination of their

³⁷ Conyon M, 'Shareholder Say-on-pay Voting and CEO Compensation' (2015) available online at http://www.cbs.dk/files/cbs.dk/call_to_action/shareholder_say-on-pay_voting_and_ceo_compensation.pdf accessed on the 8th of May 2017.

³⁸ Gerner-Beuerle C and Kirchmaier T, 'Shareholders' Votes on CEO Pay Focus Mostly on Top-line Figures' (2016) LSE Business Review, May 5th.

³⁹ Balsam S, Boone J, Liu H and Yin J, 'The Impact of Say-on-pay on Executive Compensation' (2016) 35(2) Journal of Accounting and Public Policy 162-191.

⁴⁰ The UK Corporate Governance Code (The Financial Reporting Council, 2016) D.2.2.

pay.⁴¹ Executives have influence over the internal governance mechanisms which includes the determination of their compensation package.⁴² It has been argued that the presence of the remuneration committee had no motivational effect on the executives to maximise the firm's value but rather their presence increased managerial remuneration.⁴³ The remuneration committee has not been effective in curbing excessive executive remuneration but rather seen as acting in favour of the executives.⁴⁴ This is because the remuneration committee is usually made up of executive directors of other companies who may be considered generally, to have the same goal as executives.⁴⁵ The members of the remuneration committee tend to be empathetic with the CEO because they are also CEOs of other companies and they network by interaction in executive meetings and by sitting on the boards of each other.⁴⁶ As a result of this criticism, The Prime Minister, Theresa May was proposing reforms to the composition of the remuneration committees to include employees' representatives.⁴⁷ Although the proposal did not push through, it is difficult to see how this move would have made a difference given that the executives would still be able to have an influence on the remuneration committee.

The biggest criticisms come from the use of remuneration consultants by the remuneration committee in the determination of executive pay and the impact of executive's pay benchmarking on remuneration committee decision making on pay levels. The UK Corporate Governance Code recommended that the remuneration committee should be allowed to draw advice from outside if necessary.⁴⁸ This outside advice are provided by remuneration

⁴¹ Such as O'Reilly C, Main B, & Crystal G, 'CEO Compensation as Tournament and Social Comparison: A Tale of Two Theories' (1988) 33 Administrative Science Quarterly 257-274; Singh H & Harianto F 'Management-Board Relationships, Takeover Risk and the Adoption of Golden Parachutes' (1989b) Academy of Management Executive Journal, 32(7); Conyon M. & Peck S, 'Board Control, Remuneration Committees, and Top Management Compensation' (1998) 41(2) Academy of Management Journal 146-157.

⁴² Bebchuk L, Fried J and Walker D, 'Managerial Power and rent extraction in the design of executive compensation' (2002) 69 the University of Chicago Law Review 751-846; O'Reilly C, Main B, & Crystal G 'CEO Compensation as Tournament and Social Comparison: A Tale of Two Theories' (1988) 33 Administrative Science Quarterly 257-274.

⁴³ Conyon M, 'Corporate Governance and Executive Compensation' (1997) 15(4) International Journal of Industrial Organisation 493-509; Main B and Johnston J, 'Remuneration Committees and Corporate Governance' (1993) 23 Accounting and Business Research 351-362.

⁴⁴ Main BGM, Richard Belfied and Katherine Turner, 'Is there a Negotiation Process in UK Remuneration Committees?' (2011) Research Paper Retrieved 21st December 1, 13.

⁴⁵ Conyon M & Peck S, 'Board Control, Remuneration Committees, and Top Management Compensation' (1998) 41(2) Academy of Management Journal 146-157; Bizjak J, Lemmon M, & Naveen L, 'Does the Use of Peer Groups Contribute to Higher Pay and Less Efficient Compensation?' (2008) 90 Journal of Financial Economics 152-168.

⁴⁶ Zhao Y and Renneboog L, 'Us Knows Us in the UK: On Director Networks and CEO compensation' (2011) 17(4) Journal of Corporate Finance 1132-1157.

⁴⁷ Baker S, 'Theresa May's plan to put workers on board is borrowed from Germany and France' (2016) The Independent, July 12th.

⁴⁸ Financial Reporting Council, *The UK Corporate Governance Code* (2016) D2.

consultants who are experts in market data to determine what remuneration levels would be appropriate for the executives based on the market.⁴⁹

Skovoroda and Bruce⁵⁰ examines the changes to the composition of performance, peer groups used for performance evaluation in the setting to CEO on a year-on-year basis of FTSE 100 companies realised that firms excluded relatively stronger performing peers from their peer group selection. The selection of peer groups and benchmarking of remuneration levels is done by the remuneration consultants in consultation with the remuneration committee. Research has established the fact that the remuneration consultants are not independent from the directors and their decision making tend to be influenced by the CEO given that most of them provide other services to the company and they would not want to lose those services.⁵¹ The survey carried out by ICSA⁵² highlighted the fact that some of the blame for excessive pay must lie with remuneration consultants as benchmarking has pushed up pay rates.⁵³ They recommended that the remuneration consultants need to think carefully about the impact of their decisions which might be difficult given that they are not independent from the directors. Firms are more likely to benchmark their executive remuneration against peers that pay their executives higher remuneration which in turn reflects their self-serving behaviour and greed.⁵⁴

Bender and Moir⁵⁵ research studies realised that excessive executive remuneration is driven by human greed. However, they did not address the problem as such, rather they pointed out the fact that the best practice for executive remuneration which is the use for market benchmarks to determine salary and bonus levels, significant levels of performance-related pay, the desire for executives to hold equity in their companies, the disclosure of total shareholder return compared to an index, and a perceived need for conformity, in order to

⁴⁹Ndzi E, 'Remuneration Consultants' Advice and its Effect on Pay' (2015) 57(4) *International Journal of Law and Management* 340-350.

⁵⁰Skovoroda R and Bruce A, 'Shifting the Goalpost? Analysing Changes to Performance Peer Groups Used to Determine the Remuneration of FTSE 100 CEO' (2017) 28 *British Journal of Management* 265-279.

⁵¹ Murphy K and Sandino T, 'Executive Pay and 'Independent' Compensation Consultants' (2010) 49(3) *Journal of Accounting and Economics* 247-262; Conyon M, Peck S and Sadler G, 'Compensation Consultants and Executive Pay: Evidence from the United States and the United Kingdom' (2009) 23(1) *Acad Manage. Perspect* 43-55.

⁵² Company Lawyer, 'Executive Remuneration needs a Rethink according to ICSA Survey' (2016) 37(9) *Comp. Law*. 282-283

⁵³ Company Lawyer, 'Executive Remuneration needs a Rethink according to ICSA Survey' (2016) 37(9) *Comp. Law*. 282-283

⁵⁴ Albuquerque A, Franco G and Verdi R, 'Peer Choice in CEO compensation' (2013) 108(1) *Journal of Financial Economics* 160-181.

⁵⁵ Bender R and Moir L, 'Does 'Best Practice' in Setting Executive Pay in the UK Encourage 'Good' Behaviour?' (2006) 67(1) *Journal of Business Ethics* 75-91

grant legitimacy to policies; all possessed grey areas and provided opportunity for greed to manifest. Even though they pointed out that best practice might drive good executive behaviour (in other words, limit the greedy nature of executives), they pointed out that there were many reasons why the factors should not be used as best practised. All the reasons identified could all be rounded up to one, which is greed. Academics in other jurisdiction have also demonstrated that the presence of remuneration consultants pushes up remuneration levels where the consultants are paid for other services.⁵⁶

Bender⁵⁷ pointed out that the remuneration consultants are important in the determination of executive remuneration because they act as experts that provides proprietary data against the companies which can benchmark executive remuneration. This consequently means that the remuneration committee has a direct influence on the choice of comparators and the executive remuneration as a whole.⁵⁸ Their advice is meant to be used by the remuneration committee to legitimise their decisions. However, their lack of independence has given executive the opportunity to influence the consultant's decision. Their lack of independence is also attributed to the fact that the market for executive remuneration consultants is concentrated (i.e. served by few consultants with large number of clients) and other services they offer to the company which opens up potentials for conflict of interest.⁵⁹ The act of benchmarking executive remuneration tends to push up executive remuneration.⁶⁰ Firms tend to select highly paid peers to enable them justify the pay package and levels they give to their executives. Furthermore, companies tend to engage in shopping for opinion between consultants to find favourable pay levels for their executives in which case they will always settle for the higher pay.⁶¹ This practice is argued to be stronger in firms where the executives are members of other board (such as being the non-executive director of other board and maybe sitting on the remuneration

⁵⁶ Murphy K and Sandino T, 'Executive Pay and 'Independent' Compensation Consultants' (2010) 49(3) *Journal of Accounting and economics* 247-262.

⁵⁷ Bender R, 'Paying For Advice: The Role of the Remuneration Consultant in UK Listed Companies' (2011) 64(2) *Vanderbilt Law Review* 361-396.

⁵⁸ Bender R, *Executive Compensation Consultants* (2012). *The Research Handbook on Executive Pay*, Jennifer Hill & Randall S. Thomas, eds., Edgar Elgar, (Edward Elgar Publishing, 2012).

⁵⁹ Conyon MJ, 'Executive consultants: Empirical Evidence from the United States and United Kingdom' (2007) Working Paper available online <http://www.lse.ac.uk/fmg/researchProgrammes/corporateFinance/corporateGovernance/pdf/executiveCompensationConsultants.pdf> accessed 16th May 2017.

⁶⁰ Armstrong C, Ittner C and Larcker D, 'Corporate Governance, Compensation Consultants, and CEO Pay Levels' (2012) 17(2) *Review of Accounting Studies* 322-351.

⁶¹ Goh L and Gupta A, 'Executive Compensation, Compensation Consultants, and Shopping for Opinion: Evidence from the United Kingdom' (2010) 25(4) *Journal of Accounting, Auditing & Finance* 607-643; Kabir R and Minhat M, 'Compensation Consultants and CEO Pay' (2014) 32 *Research in International Business and Finance* 172-189.

committee) and firms where the CEO has a longer tenure or where the CEO is the chairman of the board of directors.⁶² Research has demonstrated that CEOs receive higher equity-based pay when firms employ more than one compensation consultant, and an increase in the number of compensation consultants is associated with an increase in CEO pay, whereas no decline in CEO pay takes place when firms reduce the number of pay consultants.⁶³

Evidence of greed on director's remuneration

Greed can be evidenced in director's remuneration in a number of ways which include the pay for performance dichotomy, the pay gap between executives and rank profile employees and the ineffectiveness of regulatory mechanisms

Pay for performance dichotomy

Executive remuneration has been criticised due to the lack of link between directors' remuneration and company performance. Several academic studies suggested that there is a very weak (in some instances, no) relationship between pay and company performance. This is a position which seemed to be driven by greed because without greed a 'reasonable' director would want to ensure that there is a strong correlation that exist between their pay and the company's performance. There exists a wealth of academic studies in this area, however, with inconsistent findings as a result of different methods used by the academicians.⁶⁴ The directors' remuneration package is made up of different components which includes base salary, annual bonuses, long-term incentive plans (LTIP) and share options. The problem with the linking of executive pay to company performance is the lack of best practice in terms of what factors should be used to measure company performance.⁶⁵ In terms of measuring the performance of a company, academicians use a variety of performance factors which ranges from the return on asset, return on equity, total shareholder return, total revenue, earnings per share, market capitalisation, etc. Scholars use different remuneration components and different performance

⁶² Yang J and Faulkender M, 'Inside the Black Box: The Role and Composition of Compensation Peer Groups' (2010) 96(2) *Journal of Financial Economics* 257-270.

⁶³ Kabir R and Minhat M 'Multiple Compensation Consultants and CEO Pay' (2010) Research Report <http://purl.utwente.nl/publications/74065> accessed 24th April 2017.

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⁶⁵ Bennett B, Bettis J, Gopalan R and Milbourn T, 'Compensation Goals and Firm Performance' (2017) 124(2) *Journal of Financial Economics* 307-330; Holden C and Kim D, 'Performance Share plans: Valuation and empirical tests' (2017) 44 *Journal of Corporate Finance* 99-125.

measures and thereby obtaining different results, but the majority of the studies seem to suggest that directors' remuneration has a weak/no relationship to company performance.⁶⁶

Geiler and Renneboog⁶⁷ research on executive remuneration and payout decision demonstrate further the rule of greed in the director's excessive remuneration package. Their research demonstrates that corporate payout policies such as dividends, share repurchases, etc. are set by CEOs with the intent to maximize their personal wealth. They identified that the way to get rid of the greedy nature of the CEOs was to encourage firms/remuneration consultants to make top management's remuneration packages 'dividend-neutral', in other words, to remove the negative impact of the dividends on pay such that the payout and payout channel choice will not be influenced by the CEO's wealth. However, the question is how would this be possible?

The pay gap between executives and rank profile employees

The director's remuneration has been criticised because of the pay gap that exist between the directors and e ranked profile employees.⁶⁸ This pay gap have increased from 47% in 1998 to 183% in 2015.⁶⁹ Pensions and Lifetime Savings Association⁷⁰ has noted the pay gap that exist between the directors and e ranked profile employees and they have raises concern about the large pay gap in reference to pension and lifetime savings and they are echoing the need for something to be done to close the large pay gap that exist between them. Even though,executive directors are the major decision makers of the company, the success of the company is dependent on a team effort between the directors and all the employees of the company.⁷¹ The idea that companies need to pay more to attract, retain and motivate executive directors' and the market for talented executive has been challenged to be a myth.⁷² It has been estimated by

⁶⁶Ozkan N, 'CEO Compensation and Firm Performance: an Empirical Investigation of UK Panel Data' (2011) 17(2) *European Financial Management* 260-285; Bennett B, Bettis J, Gopalan R and Milbourn T, 'Compensation Goals and Firm Performance' (2017) 124(2) *Journal of Financial Economics* 307-330; Ntim C, Lindon S, Osei K and Thomas D, 'Executive Compensation, Corporate Governance and Corporate Performance: A Simultaneous Equation Approach' (2015) *Managerial and Decision Economics* 67-96.

⁶⁷Geiler P and Renneboog L, 'Executive Remuneration and the Payout Decision' (2016) 24(1) *Corporate Governance: An International Review* 42-63.

⁶⁸Connelly B, Haynes K, Tihanyi L, Gamache D and Devers C, 'Minding the Gap: Antecedents and Consequences of Top Management-To-Worker Pay Dispersion' (2016) 42(4) *Journal of Management* 862-885.

⁶⁹Sarah O'Connor, 'Chief Executive Gains a Day and Plenty More Pay, Says Pressure Group' (2016) *Financial Times*, January 4th.

⁷⁰Pensions and Lifetime Association, 'Executive Pay is Too High and Something Needs to be Done' (2017) 46(1) *Pension World* 10.

⁷¹Ndizi E, 'Directors' Duties and Employee Interest: The Case of Zero Hour Contracts' (2016) 37(5) *Comp. Law.* 135-138.

⁷²David Bolchover, 'Pay Check; Are Top Earners Really Worth it?' (2010) Coptic press

the High Pay Centre that chief executives earn on average £1,260 per hour⁷³ as compared to the national minimum wage, which currently stands at £7.20 for adult whose age is above 25 years. The Sun newspaper describes the pay gap as ‘obscene and undeserved’ when UK CEOs are pocketed on average £5.3m each year, which is 380 times more than a worker on national minimum wage.⁷⁴

Directors argue that it is their effective management that makes the company profitable, but the question is really whether the work of the director is as difficult and time-consuming as they claim and enough to justify the pay difference with an average employee.⁷⁵ Although Bolchover⁷⁶ simply argues that companies should focus more on nurturing talented people to become executive directors, this paper argues that executives are simply driven by greed to acquire more wealth. The reason put forward, which is to attract, retain and motivate directors and the market for executive talent, is just a vehicle to drive greed on. Without the force or interest to acquire more wealth and power (greed), directors will naturally without influence from the government, policy makers or the press, appreciate that the pay gap between them and rank profile employees needs to be narrow. The widening gap between executive pay and rank profile employee pay has attracted media, government and public interest since the 1990s, however, decades later, it is still an issue demonstrating the stronghold of greed in the subject matter. This greed costs the companies, the shareholders, the general public, taxpayers a lot of money as they constantly dedicate time and effort to monitor and debate on new strategies to resolve the problem. Given the stronghold of human greed on executive remuneration, it would have been difficult to see how the disclosure of executive pay ratio of employee pay ratio will curb excessive executive remuneration.⁷⁷ What the policy maker wants to achieve through this disclosure requirement is pay ‘fairness’ between the executive and the employee. Furthermore, it is unclear what this fair pay may be from an executive point of view, shareholder point of view, public point of view, employee points of view, etc. Is the way forward bringing down executive pay or increasing employee’s pay?⁷⁸ This is a time-consuming debate that not all involved may agree to one solution. However, this paper is arguing that this would not be a

⁷³ High Pay Centre, ‘Fat Cat Tuesday 2016’ (2016) January 4th.

⁷⁴ Vonow B, ‘Fat Cat Pay Gap UK CEOs ‘Earn 386 times More than average worker on national living wage pocketing £5.3m a year compared to £13k’ The Sun (2017) March 22nd.

⁷⁵ Tricot D, ‘Deserved success or mere greed?’ (1995), 2 UCL Juris. Rev. 233.

⁷⁶ David Bolchover, ‘Pay Check; Are Top Earners Really Worth it?’ (2010) Coptic press

⁷⁷ McRitchie J, ‘CEO Pay Ratios: Do Employees Care? (2016) Corporate Governance, August 4th.

⁷⁸ Edmans A, ‘Why we Need to Stop Obsessing over CEO Pay Ratios’ (2017) Harvard Business Review, February 23rd.

necessary regulation if only human greed was not the key driving force for executive remuneration.

Gupta et al.⁷⁹ in their research found that mandatory disclosure on relative increase in Chief Executive Officer (CEO) and employee pay was subject to management discretion, as firms could self-select their employee comparator groups. Disclosure is the responsibility of the board of management, which include the CEO. The greedy nature of the CEO may push the management to disclose what will promote their self-interest. This can be justified by the fact that despite the enhanced disclosure requirement, the link between CEO pay and firm performance has not be strengthened nor has the pay gap between CEO and average employee decreased.⁸⁰ Campaigns have been made by different pressure group on the gap between CEO pay and employee pay calling for the government to intervene and make strict regulation that will help to close the pay gap.⁸¹ Mr Corbyn discussing on the topic emphasised the fact that the pay gap is creating the worse levels of inequalities.⁸² This indicates that the depth at which greed has taken over executive remuneration has reach unexpected level. Medias and newspapers⁸³ have spoken and written extensively on the huge pay gap, but yet not calling the name of the cause which is greed.

The Trades Union Congress (TUC) went further to detail the extent to which the executive pay gap has gone within the Wire and Plastic Products (WPP) company in 2015. TUC analysis of Mr. Sorrell, the CEO of WPP, £70 million remuneration in 2015, represented more than 2,500 times the average UK salary of £27,645. The pay was equivalent of £38,437 per hour and TUC estimated that Sorrell's annual salary could have paid the wages for 2,218 nurses, 1,920 paramedics, or 4,479 teaching assistants.⁸⁴ Research has demonstrated that CEO-to-employee

⁷⁹ Gupta A, Chu J and Ge X, 'Form Over Substance? An Investigation of Recent Remuneration Disclosure changes in the UK. (June 21, 2016). Available at SSRN: <https://ssrn.com/abstract=2798001>

⁸⁰ Shue K and Townsend R, 'Growth through Rigidity: An Explanation for the Rise in CEO pay' (2017) 123(1) *Journal of Financial Economics*.

⁸¹ Hinchliffe A, 'Fat Cat Wednesday: CEOs Earn more by Midday than Employees all year' (2017) *Croner* <https://croner.co.uk/news/fat-cat-wednesday-ceos-earn-midday-employees-year/> accessed on the 21st of April 2017

⁸² Pickard-Whitehead G, 'Fat Cat Wednesday Reveals Staggering Pay Gap Between British Executive and Workers' (2017) <http://www.occupy.com/article/fat-cat-wednesday-reveals-staggering-pay-gap-between-british-executives-and-workers#sthash.mS7i0rML.dpbs> accessed on the 21st of April 2017.

⁸³ Somvanshi K, 'Nifty CEOs' Salary 237 times the median pay at their companies' (2017) *The Economic Times*, February 24th. Harris C., 'UK Bosses take just three days to earn the average worker's wage' (2017) *Business Day*, January 5th.

⁸⁴ TUC, 'The UK's Highest Paid CEO earns the average Annual Salary in Under 45 minutes, TUC analysis Finds' (2016) TUC <https://www.tuc.org.uk/economic-issues/britain-needs-pay-rise/corporate-governance/uk%E2%80%99s-highest-paid-ceo-earns-average> accessed on the 20th of April 2017.

pay gap has been increasing and continue to increase.⁸⁵ This pay gap tend to demotivate the employees because they feel undervalued.⁸⁶ However, this gap will not close up unless the law decides to interfere in the internal dealings of the company to make strict regulations or if executives stop being greedy.

The executive talent market

There is a growing internationalisation of executive talent (labour) market. Executives are able to use their skills in many other countries apart from their own country of origin. Executives tend to use this growing internationalisation of the executive talent market to demand for more earning if they realise that they can be paid more elsewhere. The US has been identified for paying its executives more than any other country. There are potential for talent movements between the UK and the US which will have a push-up effect of executive pay in the UK. However, it has been demonstrated that only 0.8% of UK companies recruited executives from outside the UK.⁸⁷ However, this may still have a knock-on effect on the pay levels of other executives in the UK when the companies engage on executive benchmarking exercise for the process of determining executive pay which may cause directors to move out of the companies when they realise that other companies are paying more.⁸⁸ It has been argued that the design of executive remuneration package and the process involved is an opportunistic exploitation of managerial power⁸⁹, simply put as greed.

The myth about the limited talent pool of executives has also provided a great vehicle for executive greed to ride on. CEO talent has increasingly become more and more important in the determination of executive remuneration.⁹⁰ Research has demonstrated that executive talent market has significant role in the determination of executive remuneration.⁹¹ Executives are of

⁸⁵ Conyon M and Read L, 'The CEO-To-Employee Pay Gap: Evidence from UK Firms' (July 01, 2000). Available at SSRN: <https://ssrn.com/abstract=2840487>

⁸⁶ Newton M, 'Fat Cat Bosses – Unfair Pay Gap in the UK' (2017) Capital Law, <http://comment.capital-law.co.uk/post/102dwvc/fat-cat-bosses-unfair-pay-gap-in-the-uk> accessed on the 20th of April 2017.

⁸⁷ High Pay Centre, 'The Myth of Global High Pay Talent Market' (11 February 2013).

⁸⁸ Ian Gregory-Smith and Brian GM Main, 'Testing the Participation Constraint in the Executive Labour Market' (2016) 63(4) Scottish Journal of Political Economy 399-426

⁸⁹ Lucian Bebchuk and Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Cambridge, MA: Harvard University Press, 2004); see also Bebchuk and Fried 'Pay Without Performance: The Unfulfilled Promise of Executive Compensation: Part II: Power and Pay', UC Berkeley Public Law Research Paper No.537783 (February 2004).

⁹⁰ Jung H and Subramanian A, 'CEO talent, CEO compensation, and product market competition' (2017) Journal of Financial Economics available online <http://www.sciencedirect.com/science/article/pii/S0304405X17300740> accessed on the 25th of April 2017.

⁹¹ Gao H, Luo J and Tang T, 'Effect of Managerial Labor Market on Executive Compensation: Evidence from Job-Hopping' (2015) 59(2-3) Journal of Accounting and Economics 203-220; Cremers K and Grinstein Y, 'Does the Market for CEO Talent Explain Controversial CEO Pay Practices' (2014) 18(3) Review of Finance 921-960.

the opinion that the talent pool is very limited and they tend to use this point to request for more pay. Research has demonstrated that firms that lose their executives to other firms tend to raise their pay levels to employ, motivate and retain their executives.⁹²

The way forward

The big question is how can excessive executive remuneration be curbed? There is only one way to do so, by taking away the vehicles on which human greed ride which is any position that could put the executive in a potential conflict of interest. This could mean taking the position or powers away from the executive or it could mean the policy makers disregarding the separate legal entity principle and interfering in the internal management of the company. It is very difficult to achieve either of the propositions above. The executives' power and position in the company is the basis of the potential conflict of interest, but this position is necessary for the executives to be able to make decisions in the company on a day-to-day basis. The executives are therefore running the company day-to-day basis on behalf of the company. This means that eliminating the basis of executives' potentials for conflict of interest would not be possible.

It is an established principle in company law that the company is a separate legal entity with rights and responsibilities. This means that the company is an artificial person and can take care of its own matters. This principle has formed the very basis of the company. Consequently, the policy-makers are not ready to disregard this principle and legislate on executive remuneration. It is considered that executive remuneration is the responsibility of the board of management and the shareholders. Given that none of the above proposition is possible, it can be concluded that executive remuneration cannot be effectively regulated unless the executives themselves decide to let human greed go and be reasonable in their pay deals.

Conclusion

Executive remuneration is a challenging problem because the directors are responsible for the decision making and the daily running of the company. This puts the executives at the centre of the company and also put the executives in a position with potential conflict of interest. This

⁹² Gao H, Luo J and Tang T, 'Effect of Managerial Labor Market on Executive Compensation: Evidence from Job-Hopping' (2015) 59(2-3) *Journal of Accounting and Economics* 203-220; Peters F and Wagner A, 'The Executive Turnover Risk Premium' (2014) 69(4) *The Journal of Finance* 1529-1563.

conflict of interest provides fertile grounds for human greed to manifest if the executives are not careful. Without the manifestation of human greed in executive remuneration, there will be no need for regulation. But the presence of human greed is prompting the government to interfere (even though) in a very limited manner in the internal affairs of the company in terms of directors' remuneration. However, this government interference through provisions in the Companies Act 2006 and recommendations in the UK Corporate Governance Code, has been unable to curb excessive executive remuneration. Research has clearly identified the fact that UK's measures are ineffective to address the problem.⁹³ If executive remuneration is to be effectively regulated, then policymakers must consider provisions that can eradicate the manifestation of human greed. This could mean disregarding the separate legal personality principle of the company which the policymakers don't seem ready to do. It can, therefore, be concluded that executive remuneration cannot be effectively regulated because human greed has firmly established itself in the pay determination process and pay levels as a result of the executives' position in the company and their potential conflict of interest.

⁹³Petrin M, 'Executive Compensation in the UK – Past, Present and Future' (2015) 36 *The Company Lawyer* 195.