

Association of Accounting Technicians response to the Business, Energy and Industrial Strategy (BEIS) Committee inquiry into Corporate Governance: Delivering on Fair Pay (2)

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Business, Energy and Industrial Strategy (BEIS) Committee inquiry into Corporate Governance: Delivering on Fair Pay (Executive Pay), published on 23 March 2018.
- 1.2. AAT takes the issue of executive pay very seriously. Our own Chief Executive had a pay ratio of 5:1 in both 2015 and 2016 and this will likely be the case for 2017 too. This information is published in AAT Annual Accounts.
- 1.3. AAT has been publishing its Executive Pay Ratio for several years, long before it was a legal requirement to do so.
- 1.4. AAT has added comment to add value or highlight aspects that need to be considered further.
- 1.5. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.
- 1.6. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT's 4,250 licensed accountants.

2. Executive summary

- 2.1. **The self-styled “world leading reforms” announced by government in 2017 are welcome.** However, they are insufficient to lead to significant improvements in relation to excessive executive pay.
- 2.2. **Calculating the pay ratio needs to go much further than simply comparing CEO pay with the median worker.** Instead comparisons between the highest paid and lowest paid should be made and the pay ratios between management tiers would make reporting more meaningful.
- 2.3. **The new public register of companies who receive significant votes against their pay schemes is wholly inadequate.** Almost a quarter of the FTSE All-share appear on this register. Having to provide a couple of sentences by way of explanation a few months after the event is unlikely to lead to significant behaviour change.
- 2.4. **It is not a surprise that Remuneration Committees have continued to fail to take necessary action to reign in excessive executive pay over the past 12 months in much the same vein as they have performed over the past twenty years.**
- 2.5. **New pay ratio reporting requirements will temporarily help to draw attention to the issue of excessive executive pay but will do little to address it.** To effect real change a legally binding maximum pay ratio is necessary for all large organisations. There is significant support for this amongst AAT members (3.36) and the public more widely (3.38).

3. **AAT response to the BEIS Select Committee Inquiry on Executive Pay**

3.1. The following paragraphs outline AAT's response to the proposals outlined in the Inquiry terms of reference.

What progress has been made on executive pay over the past 12 months?

3.2. In September 2017 Government published what the accompanying BEIS press release described as a, "*World-leading package of corporate governance reforms*"¹.

3.3. Whilst much of this package can be considered small steps in the right direction, the reforms are far less than was hoped for, less than originally appeared to be promised by the Prime Minister and less than the previous BEIS Committee recommended.

3.4. Nevertheless, this package did include a new requirement to, "... *force all listed companies to reveal the pay ratio between bosses and workers*" and that "*all listed companies with significant shareholder opposition to executive pay packages will have their names published on a new public register.*"²

Calculations

3.5. There has been some debate about exactly who and what should be compared in terms of individuals and the usage of mean or median averages.

3.6. The Executive Pay Ratio will likely be calculated using the CEO's total annual remuneration as a single figure and then comparing this against the average total remuneration of a company's UK workforce. This is the most simplistic approach and the easiest from a data collection perspective given such information can be extracted from existing payroll records.

3.7. The mean is easier to calculate, but the median is a more meaningful metric – AAT has always used the median measure when reporting its own pay ratio (as well as the lowest paid) and strongly recommends this be the case if averages are being reported.

3.8. It is often argued that a hedge fund or investment bank would be likely to have a very high median pay level and so their pay ratio may be low and therefore considered impressive. In contrast, a retailer with large numbers of relatively low paid shop floor staff would face the opposite problem. This so-called "Goldman-Waitrose" issue is reportedly the reason Vince Cable refused to introduce a reporting requirement when he was BEIS Secretary of State.³

3.9. The Committee should therefore consider recommending that the comparison should also be between the highest paid and the lowest paid employee.

3.10. Again, this is relatively easy to calculate and publish, as AAT has demonstrated for a number of years. The ratio of the Chief Executive's emoluments to the lowest paid employee was 8 in 2015 and 2016 compared to the ratio to the median paid employee of 5 in both 2015 and 2016.

3.11. Pay ratios between management tiers has been frequently identified as a useful measure, not least by a majority of respondents to the Government's recent Corporate Governance consultation and similarly many responses to the previous BEIS Committee consultation on Corporate Governance made the same point.

3.12. As a result, pay ratio reporting should contain three metrics for the greatest chance of success and to provide the most accurate picture of company activity: 1) the highest to the lowest paid employee ratio 2) the ratios between management tiers and 3) the preferred Government backed option of the ratio between the pay for the CEO and the median employee

¹ BEIS Press Release, August 29, 2017:
<https://www.gov.uk/government/news/world-leading-package-of-corporate-governance-reforms-announced-to-increase-boardroom-accountability-and-enhance-trust-in-business>

² ² BEIS Press Release, August 29, 2017:
<https://www.gov.uk/government/news/world-leading-package-of-corporate-governance-reforms-announced-to-increase-boardroom-accountability-and-enhance-trust-in-business>

³ Financial Times, September 21, 2016:
<https://www.ft.com/content/96dc7712-7f55-11e6-bc52-0c7211ef3198>

Public Register

- 3.13. At the Prime Ministers instigation, the world's first public register of companies that ignore shareholder concerns and award pay rises to bosses that outstrip the company's performance was published by the Investment Management Association in December 2017.
- 3.14. The register lists those companies who have suffered shareholder votes of 20% or more against pay and other policies.
- 3.15. Government stated that this register would help to tackle the "*abuses and excess in the boardroom*" and "*restore public confidence*" in big business.
- 3.16. It was obvious when announced that, whilst a miniscule step in the right direction, it would not help tackle abuses or restore public confidence. It is immensely frustrating that the solution favoured by a clear majority of AAT members and the public at large, to impose a pay ratio (as detailed at 3.36 & 3.38 below) has again been completely ignored in favour of a new measure that achieves little.
- 3.17. Almost a quarter of FTSE All-Share companies appeared on the new register and save for a day or two of negative publicity, which was quickly forgotten - and could arguably be said to have damaged public confidence in business rather than helped restore it - has had no discernible impact on company behaviour and is very unlikely to in the future.
- 3.18. AAT does not believe the register is significant or that publishing updates - whether a month, three months or six months after a vote - is meaningful.
- 3.19. Companies like Pendragon, Safestore or Entertainment One who were listed in the register as respectively having 45%, 49% and 47% of shareholders vote against their remuneration policy and similarly high opposition to their share scheme policy, are not going to suddenly alter their behaviour simply because they must publish a couple of sentences of explanation within a few months of such votes.

What steps have been taken by Remuneration Committees and institutional investors to combat excessive executive pay in the last 12 months.

- 3.20. Remuneration Committees (RemComs) largely continue to demonstrate that they are not able or willing to challenge excessive pay awards.
- 3.21. Arguing that this is due to the complexity of the pay structures in place i.e. LTIPS, bonuses, allowances and the like in addition to salary, is an incredibly weak argument that simply doesn't stand up to scrutiny. Who was responsible for this complexity in the first place? Who signed such arrangements off? In every case it will be the RemCom. If individuals on the RemCom are now unable to deal with the complexities that they have created, then arguably they should not be on the RemCom in the first place.
- 3.22. Many remuneration committees appear to be continuing to do the bare minimum necessary or in some cases even less, as demonstrated by Carillion earlier this year. Rachel Reeves MP, Chair of the Business, Energy and Industrial Strategy Select Committee, said of the Carillion RemCo actions, "*...when the walls were falling down around them, Carillion bosses were focussed on their own pay packets rather than their obligation to address the company's deteriorating balance sheets. While these directors could still walk off with bonuses intact, workers were left fearing for their jobs and suppliers faced ruin.*"⁴
- 3.23. There are dozens of examples of listed companies rewarding senior executives despite reduced profits, losses, falling share prices and the like.
- 3.24. Foxtons for example, saw their profits slump by almost two thirds last year (64%) and shareholder dividends collapsed. At the same time, their Chief Executive was awarded a £218,000 bonus and an increased salary.

⁴ Parliament, March 26, 2018:

<https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/carillion-board-greed-17-19/>

- 3.25. These frequent examples provide overwhelming evidence to support the previous BEIS Select Committee report on Corporate Governance which stated it is now “*impossible to observe a credible link between pay and performance.*”
- 3.26. There does not appear to have been any improvement over the past 12-month period.
- 3.27. Given the focus on action over the last 12 months, the Committee should note that the pay policy was approved at every single FTSE 100 company in 2017.
- 3.28. It could be argued that RemComs have been busy modifying or scrapping unacceptable remuneration proposals in response to negative media coverage, political pressure or the concerns of major investors but this is very unlikely to explain the approval of all pay policies last year.
- 3.29. Whilst noting that the points made above at 3.28 could explain a handful of companies approaches, the depressing reality is that companies will continue to pay hugely inflated salaries that almost exclusively bear no relation to performance as long as they feel they are able to do so.
- 3.30. The likes of Persimmon may be the best example of this. Having supposedly responded to shareholder and political pressure and slashed the pay and bonuses of their top three executives by £50m, they still paid them a combined total of more than £100m – not frugal by any measure and more importantly, not reflective of their individual performance over that time frame.
- 3.31. Both the incompetence and the impotency of the RemCom were clearly demonstrated here, reinforced by the fact the Head of its RemCom resigned after publicly admitting that remuneration arrangements were poorly designed and that failing to cap their LTIPs was a mistake.
- 3.32. The fact the RemCom Chair resigned but none of the benefitting executives chose to do so is yet another example of highly paid executives doing as much or as little as they feel they can get away with.

Further measures

- 3.33. AAT has long argued that a new pay ratio reporting requirement, as required in many other countries, should be introduced as a bare minimum.
- 3.34. The requirement to publish pay ratios will aid transparency, shining a light on excessive pay and act as a useful assessment tool. However, it will do almost nothing to curb excessive executive pay and policymakers need to recognise this.
- 3.35. According to the AAT Corporate Governance Survey (2017) only 21% of AAT members believe introducing a requirement to publish pay ratios is sufficient to make any difference in terms of curbing excessive executive pay.
- 3.36. Instead, a clear majority of AAT members believe the time has come for a mandatory pay ratio to be imposed as at companies like the John Lewis Group which has a 75:1 pay ratio.
- 3.37. The High Pay Centre has previously suggested a 40:1 pay ratio, in 2010 David Cameron recommended a 20:1 pay ratio for the public sector and in 2017 Jeremy Corbyn suggested the same 20:1 ratio but for private companies too.
- 3.38. There also appears to be very strong public support for a 20:1 Pay Ratio.⁵
- 3.39. The AAT Corporate Governance survey (2017) also found that 41% of AAT members want an across the board pay ratio of 20:1. This compares to 0% who felt the current average FTSE 100 pay ratio was appropriate and only a mere 7% who believe there should be no pay ratio at all.

⁵ Independent, January 2017:

<https://www.independent.co.uk/news/uk/politics/majority-of-public-support-jeremy-corbyn-s-plans-to-cap-bosses-salaries-poll-finds-a7527381.html>

- 3.40. Given all of the above, AAT recommends that much more serious consideration be given to imposing a compulsory 20:1 pay ratio (including total remuneration package i.e. shares, pension and cash salary) on all companies with over 250 employees, including charities and public sector bodies.

4. About AAT

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are more than 4,250 licensed accountants who provide accountancy and taxation services to over 400,000 British businesses.
- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any queries, require any further information or would like to discuss any of the above points in more detail, please contact Phil Hall, AAT Head of Public Affairs & Public Policy at:

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