



Neither necessary nor desirable: The adverse impacts of excessive executive remuneration on UK plc

“You have to realise: if I had been paid 50% more, I would not have done it better. If I had been paid 50% less, then I would not have done it worse”

– Jeroen van der Veer, former CEO of Royal Dutch Shell

It is often claimed that very large remuneration packages for company directors are necessary to recruit, motivate and retain those directors. This briefing contains evidence and analysis that challenges those assertions.

Are CEOs worth their pay?

- ⤴ Although CEO pay is much higher in the UK than most of the developed world (and the highest in Europeⁱ), company performance lags behind. In fact pay and performance have little connection. For example, while German CEOs receive just 55% of what US CEOs are paidⁱⁱ, the DAX has grown 5.01% more than the S&P500 over the last 5 yearsⁱⁱⁱ.
- ⤴ In the UK last year, rises in executive pay outstripped the rise in company performance^{iv}.
- ⤴ CEO pay is set by remuneration committees largely made up of other highly paid executives. Those who decide remuneration thus tend to have an unrepresentative view of normal levels of pay and tend not to question excessively generous rewards.
- ⤴ CEOs are rarely poached by rival companies – this has only happened to one FTSE 100 company over the last five years, when a CEO left for another British firm^v.

Excessive top pay is bad for business and economy

- ⤴ An excessive gap between high and low pay is associated with suppressed performance of the workforce as a whole^{vi}. This creates a market failure in which pay practices are harming company performance. Studies also show high director and CEO pay to be correlated with poor governance, which is in turn related to poorer company performance^{vii}.
- ⤴ People with low *relative* status in the workplace (associated with low relative pay) are more likely even than people without jobs at all to suffer declining mental health and its consequences in terms of low engagement, low productivity & absenteeism^{viii}.
- ⤴ Excessive incentives at the top can produce perverse behaviours^{ix}.
- ⤴ Excessive gaps between incomes are associated with higher levels of debt and economic volatility^x.
- ⤴ Studies show that pay incentives are more effective at a lower level^{xi}.

Excessive top pay is bad for society

- ⤴ High rates of income inequality (as distinct from poverty) are associated with a range of health and social problems. Numerous studies^{xii} have demonstrated correlations between income inequality and social incohesion, poor mental and physical health, poor educational attainment, teenage births, violence and social immobility.
- ⤴ There is strong and growing evidence that income inequality has negative implications for social mobility^{xiii}.

About One Society

One Society's work is based on a wealth of research which shows that large divides in income at the top and bottom of society – beyond 'proportional rewards' – are damaging to our economy and society, not just those at the bottom but right the way up. We work to promote policy and practice which reduce excessive income inequality. One Society works in partnership with The Equality Trust.

We argue that there is more than enough room for the monetary recognition of 'due desert' 2, and the requirements of competitive markets (e.g. in pay scales), while still reducing the UK's overall rate of income inequality.

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Notes

- i High Pay Commission: "More For Less: what has happened to pay at the top and does it matter?" 2011
- ii Ha Joon Chang, 23 things they don't tell you about capitalism. 2010: p206
- iii From 2007-2011 S+P shrunk by 1.31%, while the DAX grew by 3.71%.
<http://markets.ft.com/research/Markets/Tearsheets/Summary?s=569857>
<http://markets.ft.com/research/Markets/Tearsheets/Summary?s=593933>
- iv "A third of a percent: The gulf between employees' pay and chief executives' pay and the adverse impacts on UK plc."
<http://www.onesociety.org.uk/research/pay-ratios/private-sector/>
- v High Pay Commission, 2011
- vi W Hutton, 'Hutton review of Fair Pay in the Public Sector', Final Report, 2011. p74. http://cdn.hm-treasury.gov.uk/hutton_fairpay_review.pdf
- vii High Pay Commission, as above, p39
- viii Butterworth, Leach, Stazdins, Olesen, Rodgers & Broom, 'The psychosocial quality of work determines whether employment has benefits for mental health: results from a longitudinal national household panel survey'. Occupational and Environmental Medicine, 2011.
- ix "A third of a percent," as above.
- x S Lansley. The Cost of Inequality. 2011.
- xi Ariely, Gneezy, Loewenstein and Mazar: 'Large Stakes and Big Mistakes'; Research Center for Behavioral Economics and Decision Making, 2005, p16-17. <http://www.bos.frb.org/economic/wp/wp2005/wp0511.pdf>
- xii Most famously R Wilkinson & K Pickett's, 'The Spirit Level', 2010 (Second Edition), Penguin.
- xiii Crawford, Johnson, Machin & Vignoles, Social Mobility, a Literature Review, 2011, Department for Business Innovation and Skills, p.1. <http://www.bis.gov.uk/assets/biscore/economics-and-statistics/docs/s/11-750-social-mobility-literature-review.pdf>