Executive pay

Explore the CIPD's point of view on executive pay packages, including actions for regulators and recommendations for employers

Executive pay packages have become highly scrutinised in recent years. The gap between the highest and lowest earners in society is a factor in undermining trust in business and raising concerns over poor corporate governance. We'd like to see a shake-up of the Remuneration Committees (RemCos) that govern executive pay, to help them better fulfil their duties under the UK Corporate Governance Code.

Large listed companies in the UK are required to publish CEO pay ratios and to give a clear rationale and explanation of why executive remuneration levels are fair and appropriate.

Between 2011 and 2019, median CEO pay in the FTSE 100 has moved between a low of just over £3.6 million and a high of just under £4 million. In 2019, the typical FTSE 100 CEO earned 73 times more than the average (median) FTSE 100 worker and 119 times more than the average (median) UK worker.

Executive remuneration practices in these large companies can have a ripple effect across the whole economy, since smaller companies often use them as a benchmark.

When CEOs receive pay packages that the public considers excessive and which organisations fail to justify, it can undermine trust in business. Levels of executive pay that are seen as uncalled-for can also damage employee morale and motivation – perhaps not surprising when you consider that the average (median) UK worker's earnings in December 2019 bought them just £1 more in real terms than they did in March 2008.

But while the amount CEOs are paid attracts a lot of scrutiny, less attention is usually given to how they're paid and the behaviours their pay packages are supposed to incentivise. Firms often find it challenging to connect their business strategy to their remuneration strategy, or to demonstrate a clear link between CEO pay and an organisation's overall performance. It's common to see companies discussing environmental, social and corporate governance (ESG) measures as part of their business strategy but giving CEOs very little incentive to act in the interests of a wide range of stakeholders. What's more, research suggests flaws in the theories that underpin most executive reward packages.

How an employer rewards all its people sends clear messages about what it values, and organisations should report on employee reward transparently and candidly. Businesses and investors often say that a company's people are its most important asset, as well as posing one of its greatest risks. But most CEOs are not adequately incentivised to manage and develop that asset, raising concerns about the decisions they may take when faced with conflicting priorities.

Including ESG targets in a CEO's remuneration package helps demonstrate that these issues are a priority at the highest level of the organisation. The investments a company makes in the management, development and reward of its people will ultimately contribute to the organisation's financial success, but we'd also like to see more CEOs specifically and directly incentivised for making such investments.

To ensure that executive remuneration is aligned to company purpose, culture and values, and clearly linked to successfully delivering the firm's long-term strategy, RemCos need a broader responsibility for governing people and culture. In particular, we'd like to see them look at a wider range of measures to assess and reward success, in order to encourage the kind of business behaviours that benefit firms, employees and wider society.

Against the backdrop of the COVID-19 pandemic, executive pay decisions are likely to come under even more scrutiny. Responsible leaders, working hard to meet the needs of all their stakeholders, will have little trouble justifying their pay packages. But disproportionate pay for those at the top, while front line workers face pay freezes and job losses, will undermine trust in business – among the workforce, customers and wider society.

- The Financial Reporting Council (FRC) should publish guidance for companies on extending the remit of remuneration committees to cover wider workforce issues, including culture, as recommended in the UK Corporate Governance Code.

- The Government should monitor and enforce compliance with Section 172 of the Companies Act 2006 and the 2018 Companies (Miscellaneous Reporting) Regulations, which require companies to report on how they have complied with directors' responsibilities to have regard for stakeholder groups such as their employees, customers, suppliers and wider environment, while taking decisions in the long-term interest of the company's shareholders.

- The FRC should further strengthen the requirements of the Stewardship Code, so that investors do not take a tick-box approach to following the code and are required to do more than merely 'consider' how the companies they invest in manage 'diversity, remuneration and workforce interests'.

- Policy makers should support initiatives to develop frameworks for ESG reporting, such as those being developed by the International Organisation of Securities

Commission.

- To further improve pay transparency, the Government should review how employers are complying with the requirement to publish CEO pay ratios and extend single-figure reporting requirements and guidance to cover key management personnel and the disclosure of pay for the top 1% of earners.
- Boards should broaden the remit of their RemCos beyond CEO reward (as recommended by the UK Corporate Governance Code). They should evolve into people and culture committees, or at least formally extend their scope to adopt a broader, more strategic role in overseeing workforce issues (such as diversity, skills, stability and morale) that both influence pay levels and are, in turn, shaped by them. To support this, boards should review the composition of their RemCos, ensuring greater representation of professionals with HR and people management experience, as well as representatives of stakeholder communities, including the company's workforce.
- Companies should demonstrate in their annual reports, and through communications with their workforces, how their pay practices (including executive remuneration) relate to their strategy for people management and corporate culture, as well as how they relate to broader ESG requirements.
- People professionals should work with RemCos to explore with their stakeholders which people metrics, as well as other ESG measures, should be used to reward, recognise and incentivise senior executives and why. Companies should invest in their HR analytics capability to support this.
- RemCos should explore the latest evidence on executive reward and consider whether long-term incentive plans (LTIPs) are the best way to remunerate CEOs, or whether smaller and more immediate incentives would be a more effective way to incentivise the behaviours they want to see in senior leaders.

Reports

- CEO pay and the workforce: how employee matters impact performance-related pay in the FTSE 100
- Executive pay in the FTSE 100: 2020 review
- RemCo reform: governing successful organisations that benefit everyone
- Show me the money: the behavioural science of reward
- The power and pitfalls of executive reward: a behavioural perspective

Podcasts

- Executive pay and the psychology of motivation

Commentary

- CEO pay: complex solutions for complex problems