Corporate Governance And Executive Pay

Corporate governance and executive pay are two different topics and have been much studied as a separate topic in the past, but the present study analyse both topics together and strives to draw a singular analysis on future governance reforms. The trend in corporate governance around the world has evolved over the years. In 1932 Berle and Means raised the concern of the problem of separation of ownership and control in large multinational firms (Filatotchev et al., 2007)

For many years, the target of the structured executive pay was to draw in, retain and encourage the senior management and solve agency issues. However, the incentive took a unique flip wherever senior management took advantage to please its interest. These interests leading to the collapse of well-known corporations like Enron, Satyam, WorldCom. This thing changed executive compensation as corporate governance, hereafter, corporate governance rolling downside. In the UK Corporate Governance reforms were propelled by notorious scandals such as Robert Maxwell's cheating of the Daily Mirror pension fund, the downfall of Polly Peck, Bank of Credit and Commerce International and Barings Banks in the early 1990s (Lee, 2013).

Public interest is always aligned due to high-profile corporate failures, mainly with those bringing economy-damaging impacts. Carilion collapse, one of the major failures questioned the entire system of the corporate governance practices, financial reporting and the authenticity of auditor's report (Marriage and Mooney, 2018). Since the Financial reporting Council is presenting new proposals and provisions in the code of bonuses, investors are pitching their focus on excessive executive pay, this duo is trying to align executive pay with long term decision-making at companies (Marriage and Mooney, 2018). Investors, companies, politicians have made submissions to the FRC, on revamp of 25-year-old corporate governance code since 2014. Marriage and Mooney, 2018 mentioned in her Financial Times article about Theresa May pledge on corporate excess but again question arises why some of her most radical proposals got stuck. Proposals such as a)pay ratio reporting; b)register of pay protest that will in effect name and shame of all listed companies that have encountered significant investor oppositions ;c) worker representations to gain more of a voice in boardroom d)and last FRC is the custodian of UK combined code on corporate governance that listed companies are supposed to comply with or explain when they do not, what could be the reasons these proposals could not find success. (Ford and Pickard, 2017). The never-ending barrage of media coverage, the continuous row over the rising rates of executive pay even at the times of recession and widespread unemployment have worsened the already fading public confidence in the capital markets. This as a researcher interest me and I would like to explore on the effectiveness of these policies. The media publicity helps or aggravate the situation, the transparency policy controls the excessive pay or it will raise the executive pay further where company poaches the best skill from the market at massive rate. May's proposal or Watts principles, will make some changes to system? So, the goal of this study to investigate the relationship between corporate governance and executive pay and how corporate governance practices impacting executive compensation in the UK. This research will reflect 'vox pop' view, from the perspective of employees, employers and the general public view on corporate governance practices. Practices like comply and explain, pay ratio reporting, transparency and aligning the executive pay with long term organisational goals will be able to solve the real

issues of executive pay or it's the other way around. As au author I would like to research on the same line, these rules work or not? This leads to the following research question:

"To what extent the rules of corporate governance has been effective on Executive Pay"??

Literature Review

Agency issues

Agency theory is one of the most studied theories to date, whenever researcher subjects on the executive pay, agency relationship are the first that comes in the explanation. The agency relationship is defined as 'A contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involved delegating some decision-making authority to the agent' (Jensen and Meckling, 1976, p5). Separation of ownership and control stems from conflicts and agency problems. Empirical evidence states that most of the agency issues occur from this separation (Jensen and Meckling, 1976).

Companies are owned by shareholders and the board of directors is responsible to control the decision- making on behalf of the shareholders. The real problem comes in when a conflict of interest arises. The literature argues that executives take benefit of their control power to please their needs such as luxury assets, cars, personal trips while billing the cost to shareholders (Kim et al., 2010). This power is well explained in terms of information (Bebchuk et al., 2002). They argued that this invaluable information enables executives to have the upper hand on the board. This includes decision making on every aspect of the business including executive pay negotiation as well. Bebchuk and Fried (2005) argued that board decisions when negotiating executive pay arrangements can be influenced by executive power. Conflict of interest and power games have always been the two main building blocks of agency issues. Thus, agency theory and managerial theory is considered a cornerstone of corporate governance and executive compensation.

Power of Social Network

Some managerialism has expanded the horizon of power that demands the executive's social network. Hegemony theory is extended from managerial power, where managerial power stops at a firm's boundaries, class hegemony theories extend managerial power and control beyond these boundaries (Gomez-Mejia, 1994). This power stems from the social network developed by the CEO includes people from past employment, education but also other social activities like charities and club memberships. A strong and wider network results in more power to influence the board. Setting favourable executive pay is thus an outcome of the social managerial class's power to protect their interests and objectives that are at potential risk (Otten,2007).

Since the implementation of corporate governance practices, it was believed that executive pay could solve the agency issues somehow these theories and CIPD report reflect the contrasting view.

Skill, Efficiency and Wages

SEC staff article was written by Spatt (2004) on compensation that reflects if a company wants to attract talented individuals, who typically possess outstanding skills and opportunities, companies have to give high compensation. In literature, this is supported by human capital theory, that define human capital as the ‘people, their performance and their potential in the organisation’. The more skills and knowledge, the higher his human capital will be and thus be paid more (Thomas et. al,2013). Executives tend to put an extra effort if they are promised an above-market level wage and theory suggests that they like to stay long with the company (Prendergast,1999). This is a well-known efficiency wage theory.

Executive pay is considered to be the result of the value of an executive’s marginal revenue productivity plus a premium above market level to provide extra incentives (Otten,2007). Literature reflects growing organisations tend to select executive compensation packages focusing on incentive plans. Companies that have a more growing capacity and growing firms give higher executive compensation comparatively. So, is it right to say that skill, efficiency is directly proportional to wages and executive pays are linked with company performance? Let’s see some empirical evidence on this in the next section.

Executive Pay and Company Performance

Several types of research took place to answer this question if there is a relationship between company performance and executive pay. This relationship can be positive, neutral or negative and what are its effects on the company as an economic entity and its success in the current market (Junarsin, 2011). However, a negative relationship between company performance and executive pay results in agency issues, in spite of established governance practices, executives continue to act fraudulently and take advantage of their position to achieve high executive compensation.

Also, a spate of fiascos, financial scandals, unexpected company failures and examples of corporate excesses like giving high pay awards to the poorly performing company’s executives, trolled down the investor’s confidence (Keasey and Wright, 1997). As a result, executive pay even from good corporate governance got faded and tricky.

For illustration, Guardian reflects the discontent concerning the compensation of the bankers during the financial breakdown period presenting California representative Henry Waxman who reports to Lehman Brothers CEO Richard Fuld that “Your company facing bankruptcy and you keep $480m, is it justifiable (Clark and Schor,2008).

Recently again, the Gambling tech group faces Financial times headlines for the same reason from the past two years, high executive-pay of CEO, Mr. Weizer. In February 2019, Playtech forecasted its results, that were ahead of market earnings, however profits faced downfall by 50 percent, it is questionable, what could be the reasons. Head of responsible investment at Royal London Asset Management, Ashley Hamilton Claxton, who holds 5.5m pounds of shares in Playtech mentioned that he will be voting against the CEO’s pay (Alice Hanckok, 2019).

On the contrary, some researchers defend the entire concept of high executive pay. O ‘Connell (2010) had a very different approach and defend executive compensation stating that it’s all about supply and demand if you put the right talent and gifted CEO with the right organization, wonders can happen. Therefore, analysing the above opinions and indications from several studies on executive pay, it was believed that the relationship between executive pay and

company performance exists and then with corporate governance. Executive pay was meant to solve agency issues hoping for better economy and trustworthy relationships but empirical study illustrates the other side of the story.

This should also prompt questions what are the other contributing factors that plays a major role in excessive pay-out, particularly cases like Persimmon CEO, Jeff Fairburn. He was paid 47 million pounds last year. Labour MP Rachel Reeves, who chairs the business, energy and industrial strategy select committee, said this excessive pay-out is not based on company's performance or his personal's performance, its government's support.

Deep down what are the realities of corporate governance practices, it's very difficult to reflect. Every year media is covered with numerous reports on governance practices, CEOs pay, and shareholder's concern on the level of CEO remuneration.

Executive Pay and Corporate Governance

Financial scandals of world's well-known firms, such as WorldCom, General Electric, Royal Bank of Scotland, Enron, revealed the tricky side of executive remuneration. By manipulating the books, executives play with financial statements to show higher profits and earning high executive compensation. Bernie Ebbers, founder and former CEO of Worldcom, was involved in Worldcom fraud of $11 billion and sentenced to 25 years of prison. (Neokleaus, no date). Wearing (2005), explained that, formed CEO juggled some profits and loss expenses from books to show improved earnings and made an attempt to delay WorldCom's bankruptcy. Midnight bonuses were continued to be given to Executives as compensation rewards, even before the total failure. (BBC News, 2006).

Reasons for all these stated failures can be many such as weak corporate governance; weak accounting-based processes; a virtual link between the performance of the company and executive pay; real link is missing between two; complex stock options; missing transparency or earning manipulations and lack of reporting. Bebchuk and Fried (2005) and Jensen and Murphy (2004) argued the problem is not high compensation but not being linked with company performance (cited in Otten,2007, p23).

Awareness of the subject is spreading and worldwide governance practices are taking hold on corporate systems. Cuñat, V., M. Gine and Guadalupe, 2015 stated that OECD, 2010 reports that if not universal but many countries have accepted the concept of say on pay and implemented this in terms of voting by shareholders and transparency of executive pay and this results in a substantial increase of firm value (cited in Goergen and Tonks,2019, p5). CEO pay got down by 7% and sensitivity of CEO pay to firm performance is up by 5%, post-adoption of Say on Pay practice. (Correa and Lel, 2016). These effects are reflected in firms with long CEO life, high levels of pay, with a history of shareholder dissent and less independent boards.

UK Government's Green paper announcement gives a clear picture of its intention on legislation on pay ratio reporting, and transparency of executive pay roll out. (Department for Business, Energy & Industrial Strategy, 2017). Iliev et al. (2015) argue that the most effective mechanism around the world is shareholder voting. Post-2008 downfall, UK regulators targeted executive pay in many ways (cited in Goergen and Tonks,2019, p5). UK regulators recommended that alignment of compensation and risk responsibility should be in the hands of the remuneration committee; transparency should be the criteria in setting the compensation

and level of executives; long term profitability should be aligned with performance benchmark; the incentive pay should be delayed to avoid short-termism.

Since 2017, in the UK, pay transparency has been spread to all major sectors and across the hierarchy. Finally, another major important development is said on pay in many countries, which means executive compensation packages have to be approved by shareholders.

In conclusion, there are numerous studies, theories empirical study and practices are placed on relationship between corporate governance and executive pay, question is how deep these practices and theories are reflecting solution to the current problems of executive pay , to what extent practices like transparency, pay ratio report or say on pay will work in bringing the regulation on executive pay. This is our research objective:

Research Objectives And Research Questions

As mentioned in the literature review, there is a substantial amount of research done on corporate governance and executive pay separately. However, there is not much research done on the impact of corporate governance practices on executive pay. Therefore, this study aims to investigate how corporate governance practices impacting executive compensation in the UK.

General Research question:

The following objectives are defined

- To what extent transparency and pay ratio reporting effect the regulation of executive compensation in the UK.
- To examine the importance of “Say on Pay”, how this policy effects the regulation of the executive pay system in the UK.
- To what extent “comply and explain” practice able to solve the issues of corporate governance in the UK.
- To conclude the vox pop view observed in the survey.