How Shareholder Committees can control executive pay and restore responsible company ownership

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UK public companies have a problem; they have become what Lord Myners refers to as 'ownerless corporations'. Shareholdings have become fragmented and fund managers are often focused on the short term – which means shareholders often fail to exercise proper oversight of the companies they own. ***Chris Philp MP*** *outlines how Shareholder Committees should be introduced to help rectify these issues.*

For capitalism to work, the holders of capital (i.e. shareholders) need to exercise a measure of control and oversight over the companies they own. Without this, directors may simply run corporations in their own interests. For example, Shareholders today often merely rubber stamp recommendations for Director nominations and have a very limited formal role in setting executive pay. Symptoms of this are escalating executive pay and over-ambitious expansion and takeover plans. This can lead to bad outcomes for the shareholders and for society as a whole.

As a consequence of poor shareholder oversight, total CEO pay in the UK has rocketed, and now stands at around £6 million per year on average, or 150 times average worker income. The doubling of the ratio of CEO pay to employee earnings in the last 12 years is best explained as a failure of governance. Excessive pay is a symptom of a weak board and poor shareholder engagement. Public opinion is very firmly of the view that CEO pay is excessive, poorly linked to performance, and counter-productive to staff motivation. The public is right.

The relationship between pay and performance is weak. Between 2000 and 2013 total CEO remuneration grew 233%, but most measures of corporate performance only grew by between 50% and 90% over the same period. At the same time, workers' wages stagnated.

Academic studies have, surprisingly, shown high executive pay actually leading to relative under-performance. High CEO rewards seem to follow even indifferent or poor performance. A study published in July 2016 by MSCI found a negative correlation between executive pay levels and performance. Their summary states:

> *"Has CEO pay reflected long-term stock performance? In a word, "no." Companies that awarded their Chief Executive Officers (CEOs) higher incentives had below-median returns based on a sample of 429 large-cap U.S. companies observed from 2006 to 2015. On a 10-year cumulative basis, total shareholder returns of those companies whose total pay was below their sector median outperformed those companies where pay exceeded the sector median by 39%."*

There is significant recent evidence that the most highly paid, overconfident managers with the longest tenure have the most negative impact on returns – a finding consistent with the notion that weak board oversight is at the core of the compensation predicament.

Reform is needed. Firstly, there should be mandatory disclosure of the ratio of the CEO total remuneration to median employee pay. Publishing this emphasises the idea that a profitable company sustains all those who worked towards that profit. Publishing the ratio will make a statement about how pay at the top compares with pay throughout the rest of the organisation.

Secondly, shareholders in UK listed companies currently only have a binding vote on pay policy once every three years. The actual amount paid to Directors each year is only subject to an advisory vote. Due to the complex nature of performance based pay, the packages actually paid are often in excess of the previously stated maximum, or exceed what shareholders think is reasonable bearing in mind performance. Advisory votes against remuneration are often ignored by Boards. The annual vote on the remuneration report should therefore be made binding.

The retrospective nature of such a vote means shareholders can take an informed and impactful decision based on the known performance of their investment and the known quantum of executive pay. International precedent exists for binding annual votes on pay. Shareholder resolutions on remuneration policies are binding in the Netherlands (2004), Denmark (2007) and Switzerland (2014).

Finally, Boards have become too detached from their shareholders and other stakeholders. I propose to reform corporate governance by adapting the Swedish concept of a shareholder committee.

The formation of a Shareholder Committee (SC) should be mandatory for all UK main-market public companies, comprising the largest five shareholders. If a shareholder declined the option of taking their seat, it would pass to the next largest shareholder on the list. A list of shareholders declining to take their seat on the SC would be published, so that their own investors could seek an explanation as to why the opportunity had been declined.

The SC would be chaired by the largest Shareholder. Like in Sweden, the main Board Chairman would attend the SC and could speak, but would not vote. In order to allow shareholders to hear other stakeholder views, an elected employee representative (not a trade union representative) could also attend and speak at the SC, but not vote.

The SC would exercise the following three powers:

1. Replace the Nomination Committee and assume responsibility for recommending the appointment and removal of Directors for a vote of all shareholders at the AGM. This will make Directors more accountable to Shareholders and not the board Chairman
2. Approve the pay policy and specific pay packages proposed by the Remuneration Committee before they are put to a binding vote of all Shareholders at the AGM. This allows for proper pre-scrutiny by shareholders before the AGM vote takes place and avoids binary confrontations at the AGM
3. Pose questions requiring a response by the main Board, including on corporate strategy and corporate performance. This formally empowers shareholders to raise issues with the board, while still firmly leaving the board ultimately responsible for strategy and performance

The board would of course remain legally responsible for the wider interests of the whole company (and stakeholders in the broadest sense) besides just shareholders.

By adopting these reforms, shareholders can take responsibility as custodians of the companies they own. It will better control executive pay, and make for better companies and a better society.

Please note: *there will be an event discussing the arguments in this blog on Monday 5th September 2016, 4 – 5.30pm at Committee Room 19, House of Commons. The event is co-hosted by the High Pay Centre who note: 'The High Pay Centre, while not yet endorsing every single element of the paper, is delighted to co-host this event and acknowledge Chris's bold contribution to debate.' To attend, please respond directly to Chris.Philp.MP@parliament.uk*

About the Author

Chris Philp studied Physics at Oxford. He began his career at McKinsey before becoming an entrepreneur. He floated his first business on the stock market and has founded businesses in distribution, finance and real estate. Chris became the Conservative MP for Croydon South in 2015 and is a member of the Treasury Select Committee. He tweets @chrisphilp_mp