

The Ethics of Executive Remuneration:

A Guide for Christian Investors

The Church Investors Group (CIG) is a group of investors connected with the Churches of Britain and Ireland, handling combined assets of about £12.6 billion. They seek to formulate investment policies based on Christian ethical principles, assist each other in putting such policies into practice, encourage responsible business practice through engagement with corporate management, and share information and views on ethical matters related to investment. They commission reports on controversial issues. In response to the growing public concern at allegedly excessive pay awarded to many senior corporate executives, they recently commissioned a report on the ethics of excessive remuneration. The authors were Richard Higginson, Director of Faith in Business and co-editor of this journal, and David Clough, Professor of Theology and Ethics at Chester University.

The report runs to over 10,000 words, so it is far too long to publish in FiBQ. However, we are able to reproduce a summary which was published with the report, providing the essence of what it contains. Readers who would like to read the full report can find it on www.churchinvestorsgroup.org.uk/issues/executive-remuneration.

Summary

1 Executive remuneration: The current situation

Current levels of executive pay in the UK are strikingly high: a 2008 survey showed the highest earner as being paid £23m annually, with 34 receiving packages valued at more than £5m. The average Chief Executive Officer (CEO) package in the FTSE top 100 was £2.9m. The average salary of a FTSE 100 employee is £26,000, so the pay of FTSE CEO's is on average over 100 times that of average salaries in these companies. In 1970 this differential was approximately 10:1. The UK is reckoned to be second only to the US in executive pay.

2 A cause for concern

2.1 General ethical objections

Critics of these levels of executive pay judge them unfair because they overvalue the contribution made by chief executives. Defences of high executive pay on the basis of market rates fail to recognize the ways in which the market

differs from free market conditions. Shareholders are disadvantaged by competition between companies on levels of top executive pay and this competition also risks attracting candidates more strongly motivated by their own financial interests than the interests of the company or its shareholders. It is unclear that high pay is a significant motivator for top executive performance: senior executives may be motivated to work hard and serve their company well for a whole variety of reasons.

2.2 Particular crisis-related concerns

The global financial crisis heightened public concern about excessive executive remuneration, especially in relation to banking and financial institutions seen as bearing some responsibility for it. Such institutions seem to have been cavalier regarding the risk of their strategies and this approach may well have been encouraged by remuneration policies. Market mechanisms were not successful in limiting the adverse effects



of remuneration policies on risk management and executives have often escaped the consequences of their mistakes.

2.3 Church investment

Church investors have been active in voting against excessive pay packages, but the theological and ethical basis for this stance has not yet been made clear.

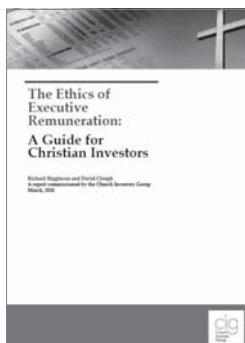
3 Theological considerations

3.1 Distributive justice

The Bible makes economic justice a central focus of its moral concern. Biblical accounts of justice include four elements: impartiality between persons, rendering to each what is their due, respecting proportionality between labour and its reward, and recognising the normativity of judgements rooted in God's moral law.

3.2 Wealth

The Old Testament sees wealth as a good gift for God's people to enjoy, but it is stern concerning the misuse of wealth and its dangers. The wealthy are expected to be generous and are warned of the potential for wealth to make them greedy and turn them from God. The prophets condemn the rich who oppress the poor, love luxury and flaunt their wealth. In the New Testament, Jesus warns against the idolatry of serving Mammon in place of God, tells the rich young ruler to sell his possessions and makes clear how hard it is for rich people to enter the kingdom of God, though some of his followers and members of the early church are among the wealthy. Christian attitudes to wealth in the later history of the church include medieval ideals of monastic poverty and a Reformation emphasis on the legitimacy of using God's gifts in business. 19th century Christian entrepreneurs who founded successful businesses were often generous with their wealth and careful to treat their employees well. The rich in the twenty-first century seem to be less generous.



4 Investors' responsibility

Shareholders have a responsibility to exercise proper stewardship of the companies in which they invest, but often fail to do so. Even serious long-term institutional investors suffer from the 'agency problem' of the gap between shareholders and the board and their respective interests. Several of Jesus' parables relate to the stewardship of resources and picture stewards being judged on long-term performance, with attention to both financial and inter-personal behaviour. Recent reports on remuneration policies emphasise non-financial measures of performance and advocate that such policies should promote effective risk management.

5 Conclusions

5.1 Theological values

Four theological values arise from the analysis of the report:

1. Concern for the poor. Investors should be more concerned with helping the poor than restraining the rich, and therefore even more vigilant about levels of pay at the bottom of an organization than those at the top.
2. Just pay. Market arguments for unrestricted pay policies should be rejected on the grounds of distributive justice and in recognition that the markets in question are not sufficiently free to set remuneration appropriately. Pay differentials are more important than outright value, and attending to differentials makes clear that some companies have fairer policies than others. Investors should examine the ratio between top executive pay and the average pay of the lowest 10% of employees, and set an appropriate rule of thumb for engaging with companies. The authors suggest 75 as an upper limit for this ratio, reduced over time through engagement with companies. It is also crucial that remuneration packages be made simpler and more transparent in order to judge whether they are proportionate.



3. The dangers of wealth. Attracting candidates with high levels of pay means they are disproportionately likely to put their own financial interests ahead of those of the company and its shareholders. Companies seeking to enhance their prestige through competitive remuneration policies are operating in clear opposition to shareholder interests.
4. Good stewardship. Remuneration for those such as CEOs responsible for stewarding the resources of others should be based on long-term performance and appropriate attitudes to risk. Investors should object to overly generous severance packages and encourage 'claw back' mechanisms to recover remuneration that proves to have been awarded on the basis of mistaken estimates of performance.

5.2 Recommendations

1. Investors should be most concerned about pay for the poor.
2. Investors should consider corporate pay differentials as more important than absolute pay packages. A maximum multiple of the ratio between the pay of the top executive and that of the average pay of the lowest 10% of employees should be identified, and over time the ratio should be set on a downward trajectory. In the opinion of the authors, it would be difficult to justify a ratio in excess of 75 times.
3. Investors need to hold executives to account over performance – with an emphasis on sustained performance.
4. Investors should discourage companies from seeking to compete with one another through levels of executive remuneration, recognising the disadvantages of motivating senior executives primarily through concern for their personal wealth.
5. Investors should dissuade companies from offering pay packages which encourage high-risk behaviour.

6. Investors should encourage companies to adopt simple and transparent packages of executive remuneration in order to facilitate accountability.
7. Where companies operate executive remuneration policies at strong variance with these recommendations and investor engagement with a company does not lead to any change of policy, disinvestment should be considered.

Afterword by Richard Higginson

The report attracted a fair degree of media attention, with Bill Seddon, who heads the Central Finance Board of the Methodist Church, being interviewed about it on Radio Four's Today Programme. Not surprisingly, media interest centred on the 75:1 ratio: why that rather than any other figure? David and I would be the first to admit that the figure is rather arbitrary, and would not want readers' views of the report to stand or fall by whether they agree with it. We decided to settle on a figure which is significantly lower than the current average (because we do believe the current upward trend needs reversing) yet high enough to enable church investors to remain engaged with the majority of FTSE 100 companies (and therefore having the potential to influence them).

Ironically, after the publication of the report and quite unknown to us at the time of writing, a BBC programme about John Lewis revealed that 75:1 is the maximum pay differential they use in calculating salaries. Andy Street, John Lewis's Managing Director, earns a very modest salary compared with Sir Terry Leahy, Chief Executive of Tesco, whose pay differential rose from an already high 526:1 in 2008 to a staggering 907:1 in 2009. John Lewis and Tesco are both highly successful retailers, but they appear to operate according to radically different philosophies, certainly with regard to pay and share ownership. John Lewis' impressive performance through the recession appears to confirm our argument that excessive executive pay is not necessary to ensure strong corporate performance. ■



Andy Street, CEO of John Lewis



Sir Terry Leahy, CEO of Tesco