

TOP PAY IN THE UK

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ED FISHER



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TOP PAY

- An overview of top pay in general
- Review of some CEP work on bankers' bonuses
- Preview of new work analyzing pay in Britain's largest firms (top 300) from CEO to cleaner

OUTLINE

1. Trends in Top Pay over the Century and Decade

2. Who are the Top Paid?

3. Our new research: Data

4. Our new research: Results

5. Conclusions

- Are CEOs paid too much
- Policy

SHARE OF INCOME GOING TO THE RICHEST INCREASES SINCE 1979 IN UK

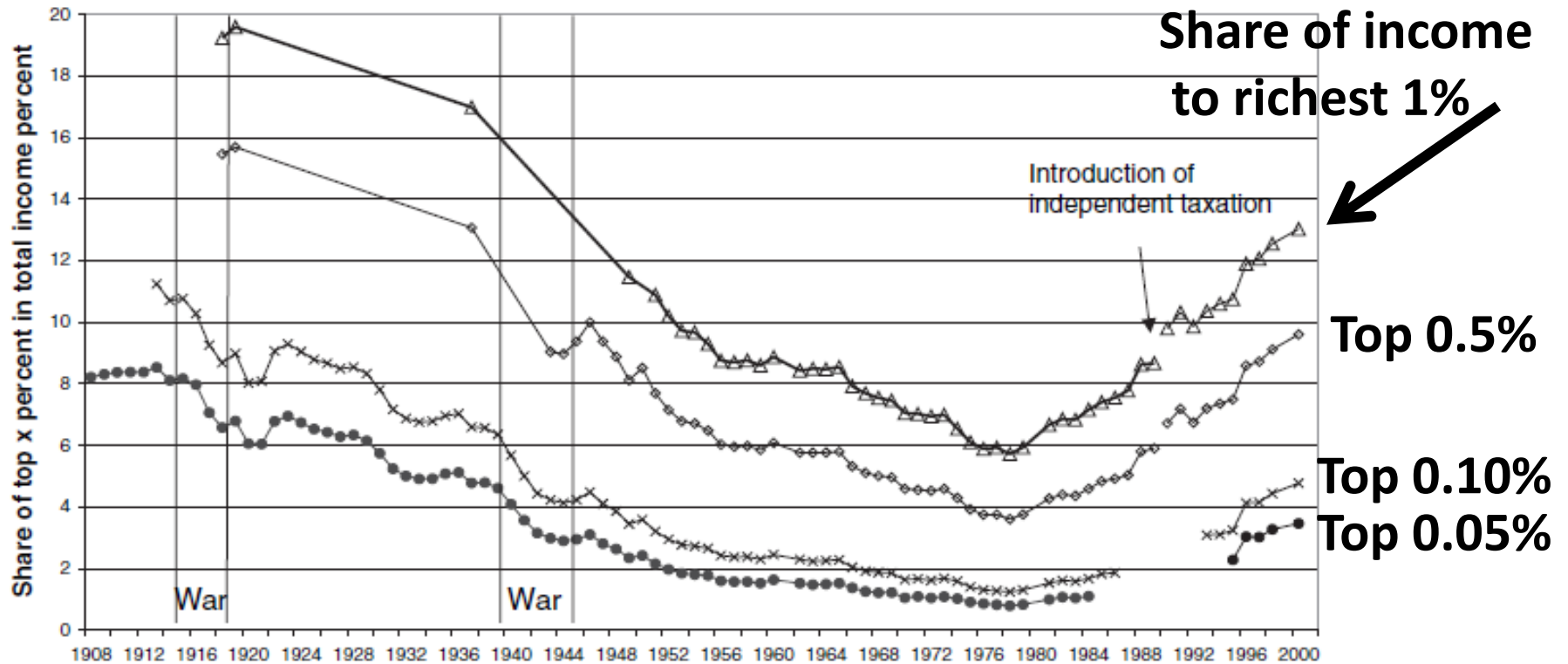
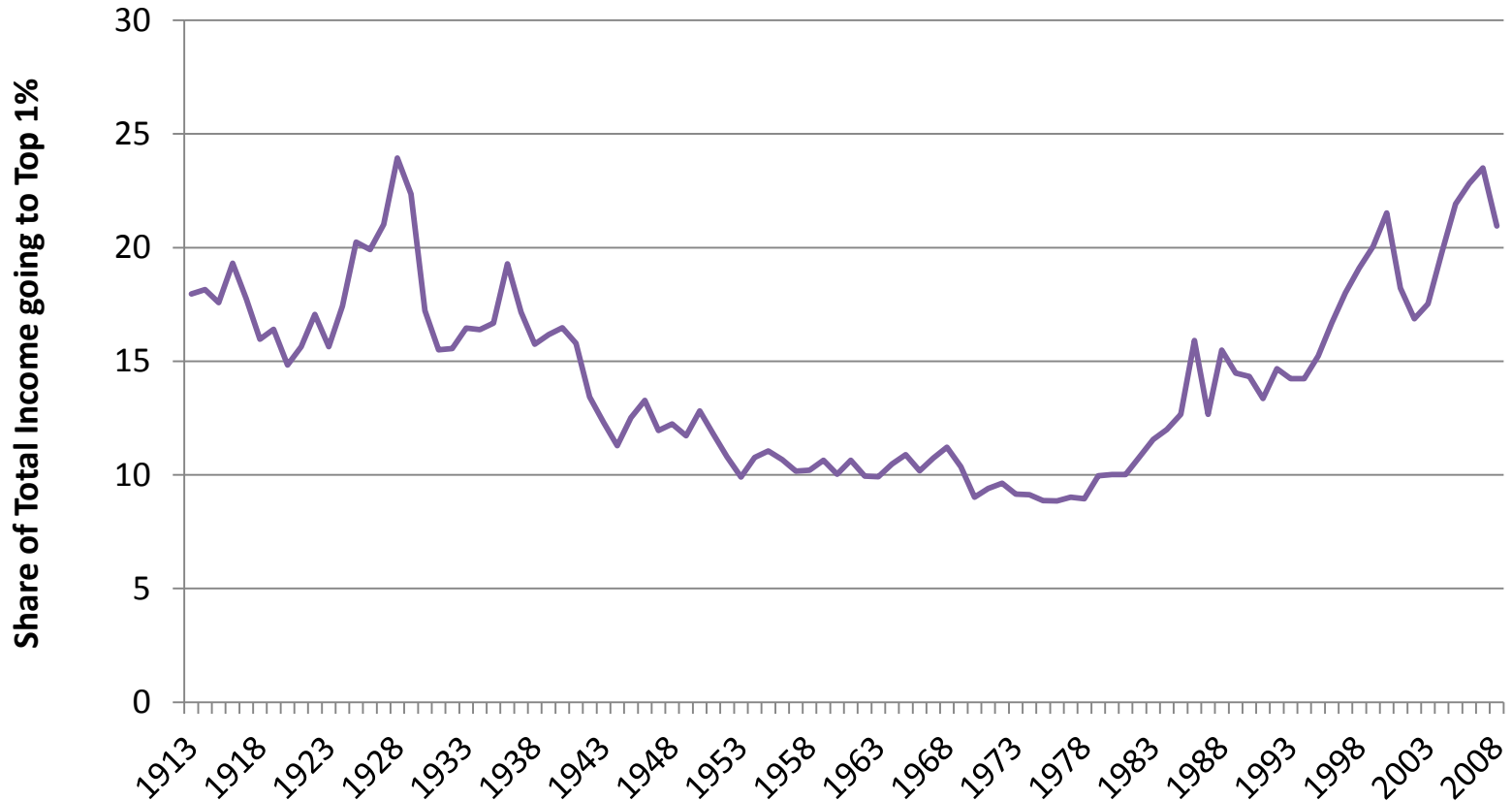


Fig. 2. Share of total personal income of the top percentile groups in the UK, 1908–2000: ●, top 0.05%; ×, top 0.1%; ◊, top 0.5%; △, top 1%

The Richest 1% take about 14% of all income – highest since WW2 (but lower than interwar period)

SHARE OF INCOME GOING TO THE RICHEST INCREASES SINCE 1979 IN US. BACK TO THE LEVELS OF THE 1920s



Income Share of the richest 1% in the US 1913-2008

THE LAST DECADE

- Overall wage inequality grew faster in 1980s than 1990s & 2000s, but in 2000s winners were those in top 1%
- The top 1% of earners increased their share of the total income pie by 2.8 percentage points.
 - Other 9% of the top decile, increased their share by 1.1pp.
 - Most of gains were for employees not entrepreneurs or non-labour income such as savings and dividends.
- Who are these top earners?

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PAY OF TOP WORKERS: DIFFERENT PROFESSIONS

Job	Pay in 2000/1	Pay in 2008/10	% Change
Manchester Utd Footballer	£357,000	£941,000	164%
Top Barrister	£286,700	£535,417	87%
BBC Director General	£454,000	£834,000	84%
Editor, The Guardian	£253,000	£455,000	80%
PwC Partner	£472,000	£759,000	61%
<u>CEO - FTSE350</u>	<u>£969,000</u>	<u>£1,479,000</u>	<u>53%</u>
Open Golf Champion	£600,000	£900,000	50%
Cabinet Secretary	£167,500	£237,500	42%
Bank of England Governor	£238,491	£305,764	28%

Notes: PwC data relate to the average profit available for distribution to partners. Top Barrister earnings are median pre-appointment earnings of High Court Judges. MU Footballer takes the annual wage bill of Manchester United, assumes 50% goes to players and divides by an estimated 70 players (this is likely to be very conservative). CEO data only goes up to 2008 – recent press reports suggest that a substantial increase has occurred for this group since then.

PUBLIC SECTOR FAT CATS?

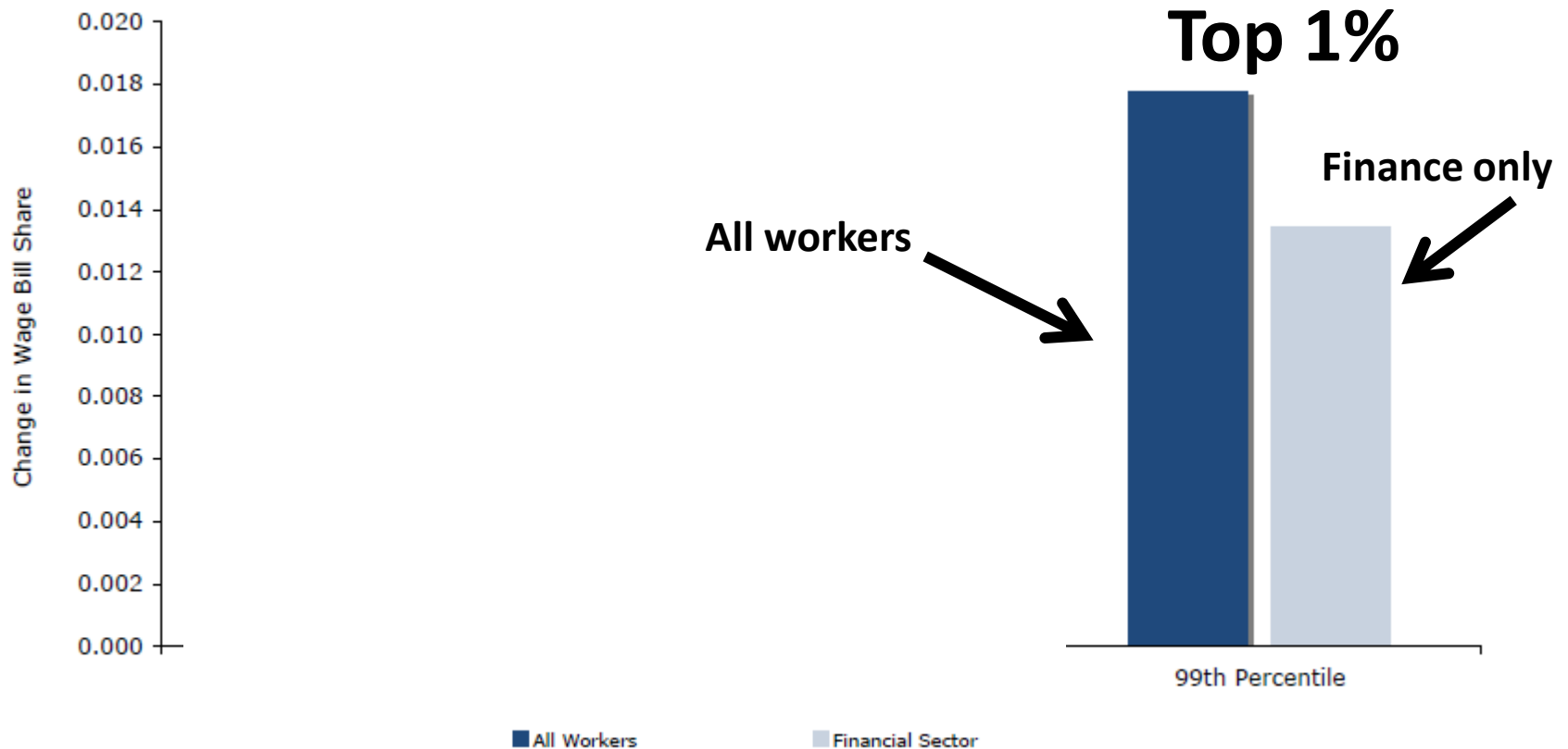
- Hutton Review: high pay in public sector
- Public administration, health & education account for 26% of total wages & 29% of workers.
 - But only account for 14% of the top 10% of earners and 3.5% of the top 1%.
- If you want to be a fat cat, working in the public sector is not the best route.....



BANKERS AND BONUSES

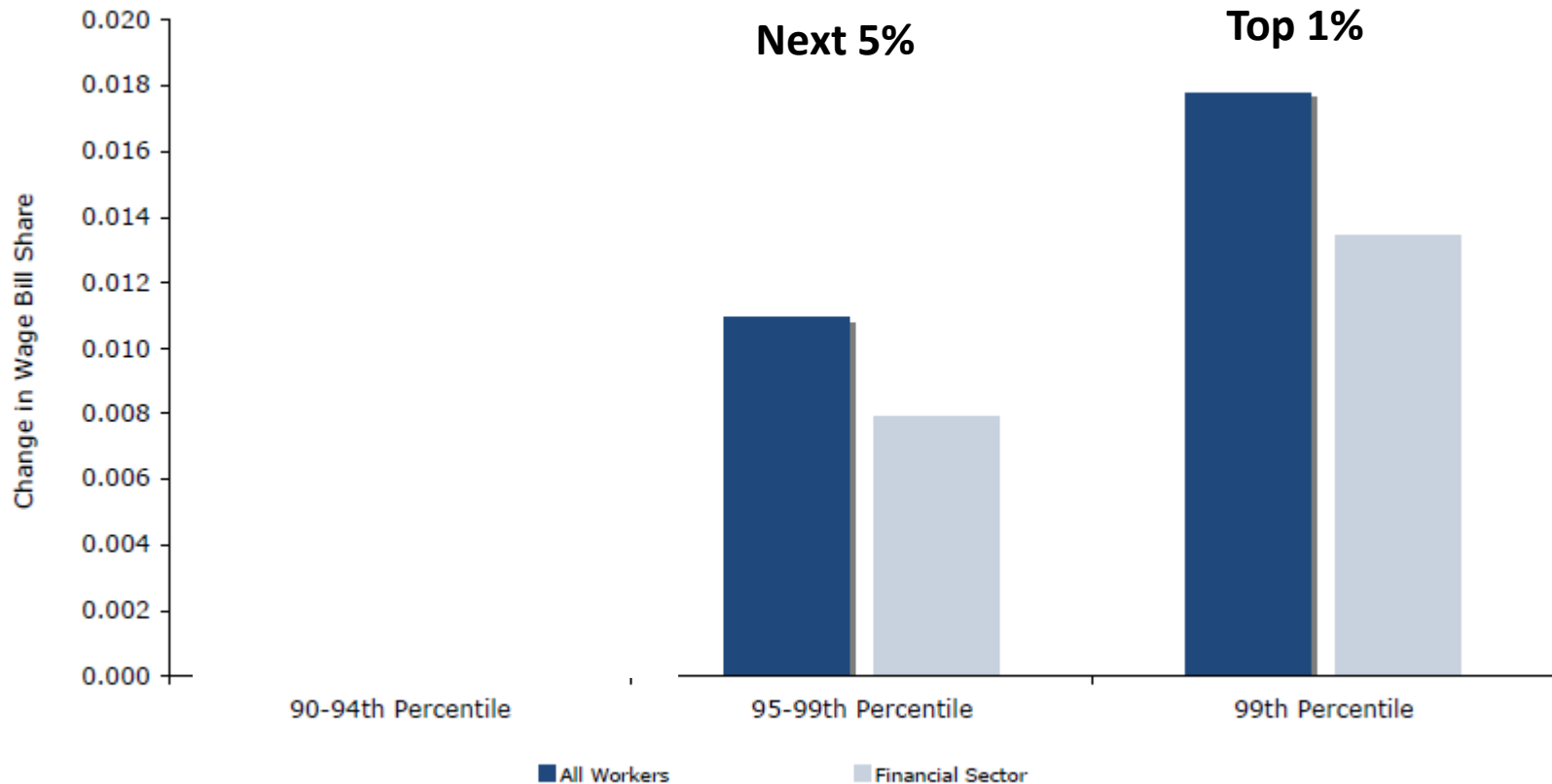
- Those at the top of most professions/industries saw relative gains during the last decade
- 5% of people work in finance (~1m), but they accounted for around two-thirds of the gains in income share for the top 1% (and the top 10%) over the last decade
- Particular concern because of incentives in financial sector to take on too much risk (see next presentation by Tim Besley)

INCREASE IN THE SHARE OF THE WAGE BILL GOING TO TOP WORKERS IN WHOLE ECONOMY AND IN FINANCE



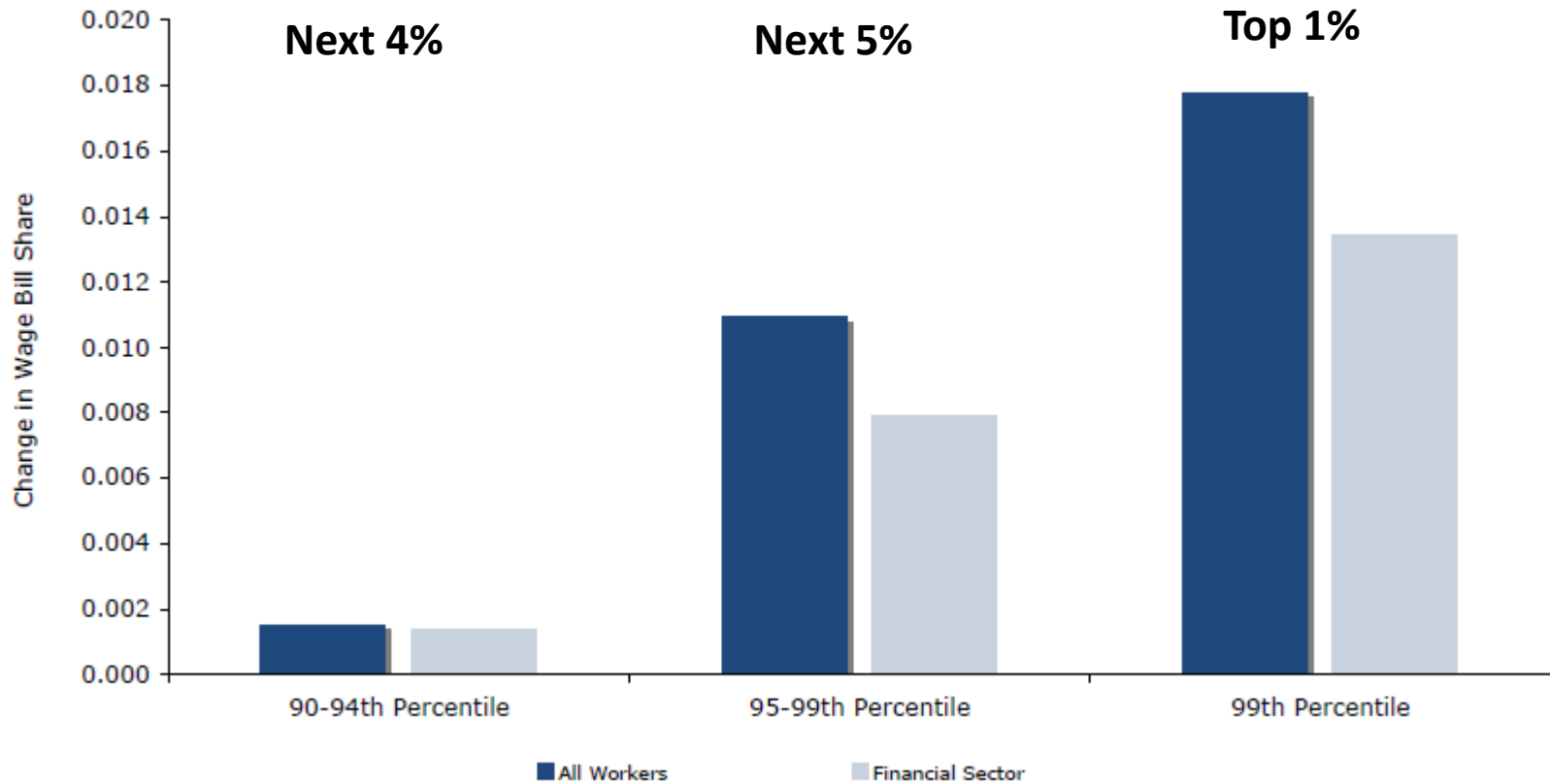
**Top 1% got an extra 1.6% of the income pie 1998-2008:
but this was almost all finance workers**

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Source: Bell and Van Reenen (2010)

FAT CAT CEOS?

'What is apparent is that ...increases in pay appear to have little connection to the added value of an executive's performance.'

(Interim report of the High Pay Commission, May 2011)

'I want to see progress ... in bringing excessive, unjustified, executive pay under control. ... Ridiculous levels of remuneration are going unchallenged as the norm, when there is no clear evidence of a correlation with performance.'

(Vince Cable's address to the ABI Conference, 22 June 2011)

'What is unacceptable is soft targets delivering high returns.'

(Sir Roger Carr, CBI press conference, 6 June 2011)

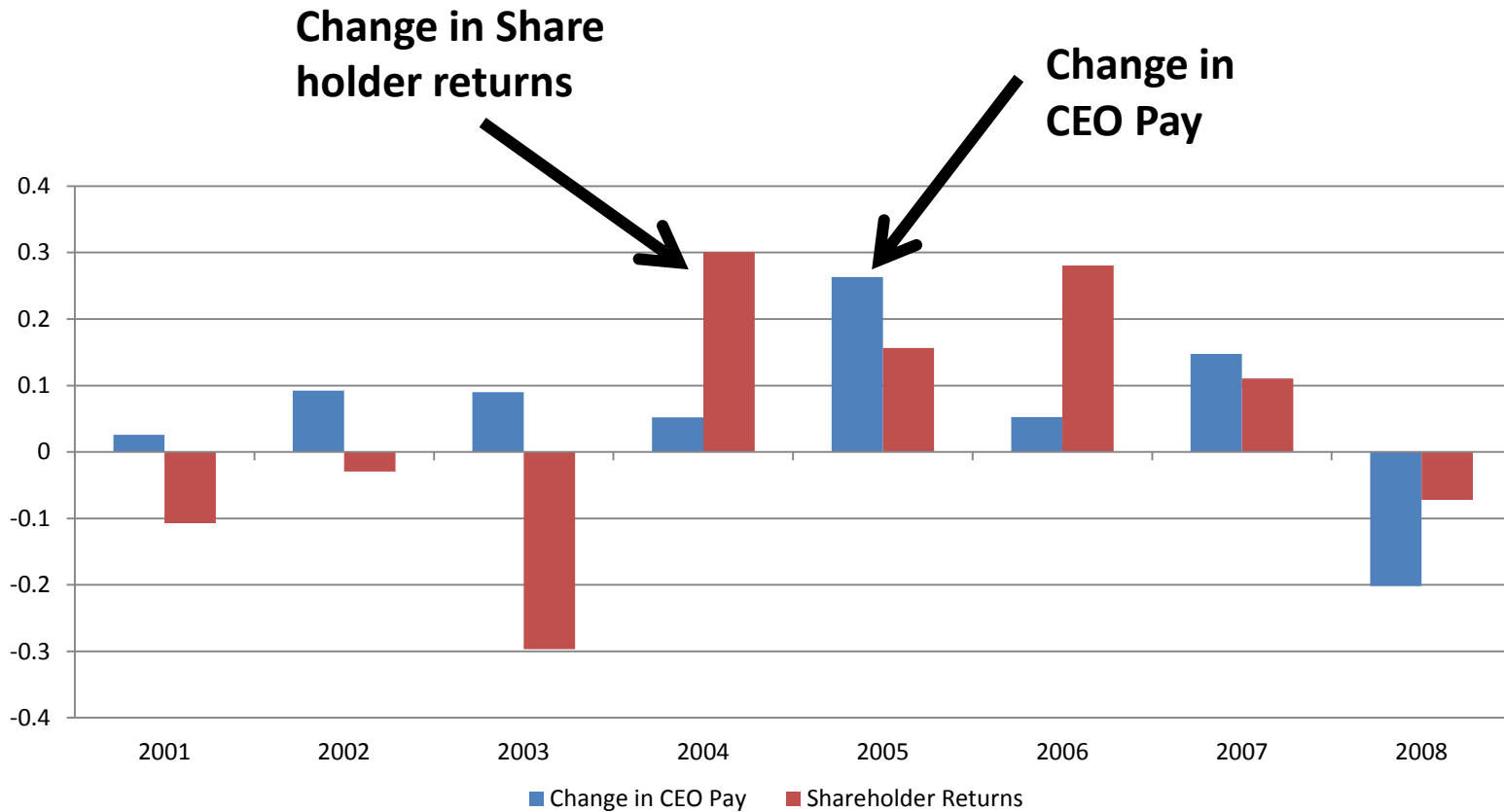
'We are so conditioned to excessive executive pay that there is a frisson to the news that a corporate fat cat has lapped from a smaller saucer of cream.'

(Financial Times: Lombard, 8 June 2011)

'[In] parts of the private sector ... executives only have degrees of upside and no downside to their pay.'

(Foreword, Hutton Review of Fair Pay in the Public Sector: Final Report)

IS RISING CEO PAY BECAUSE THEY IMPROVE THE PERFORMANCE OF THEIR FIRMS



- Link of pay and performance positive, but not tight. Seems to be increasing over time
- But hard to tell from averages – need to look at firms in detail

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OUR NEW RESEARCH

- **A new dataset on UK Pay and Performance**
- **Executive compensation** taken from company accounts (Boardex) & Towers-Watson (TW) survey of 1000s of top managers. TW has detailed information on options, shares, long-term incentive plans, bonuses, etc.
- **Worker pay** for same firms from government NI records (ASHE)
 - For first time can look at effect of firm performance on pay at all levels of the corporate hierarchy
- 424 stock exchange firms covering almost 90% of UK stock market capitalisation
 - Panel data of matched firms and employees since 2001 (~100,000 observations)

AVERAGE PAY ACROSS THE FIRM

- **CEOs:**

Total Compensation = £1,191,000

Salary = £416k (35% of total – 2/3 is bonuses, shares, etc)

- **Level 2 (just below CEO):**

Total Compensation = £616k

Salary = £242k (39% of total)

- **All Managers:**

Total Compensation = £50k

Salary = £42k (84% of total)

- **Workers:**

Total Pay = £21k

Salary = £20k (95% of total)

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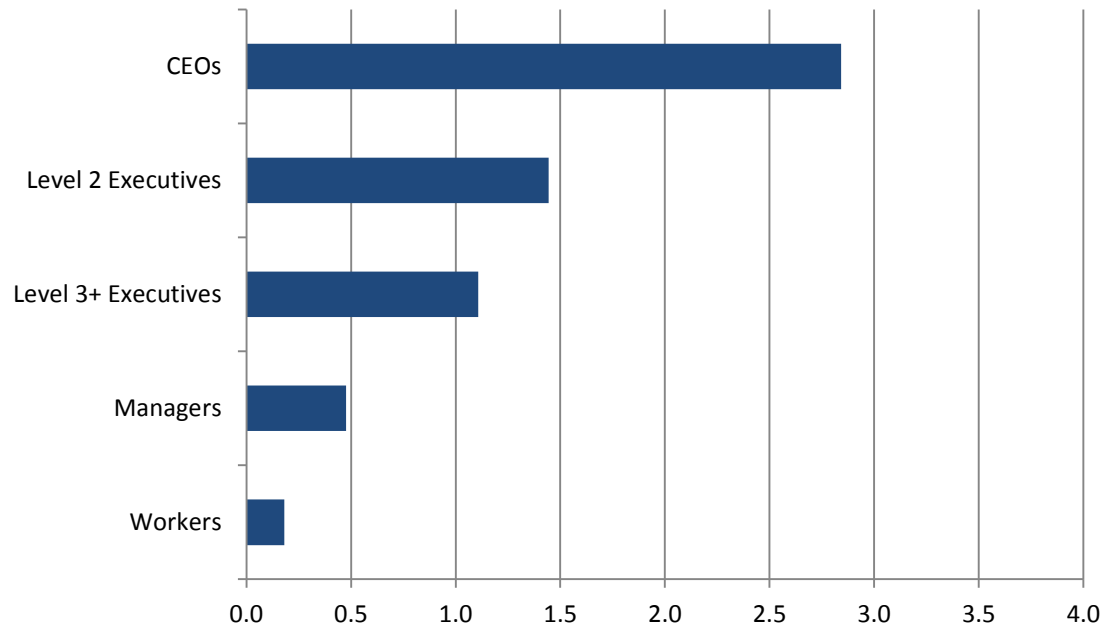
SOME KEY QUESTIONS

1. Does pay respond to firm performance, and which employees gain the most?
2. Do CEOs only get the upside or does pay fall when performance is poor?
3. What component of pay responds to performance?
4. Does performance have an effect on the CEO leaving?
5. Can performance explain any of the increase in the relative gains of CEOs compared to other workers

WHAT HAPPENS TO PAY WHEN FIRM PERFORMANCE INCREASES? (1/5)

- Examine the same firm and employee over time
- Correlate the increase in compensation for different employees (CEO, manager, average worker) when performance increases
 - Look at growth in Total Shareholder Return (TSR), profits and sales per head as alternative measures of firm performance
 - Control for the match between employee and firm
 - Control for general state of economy, firm size, outside opportunities, etc.

WHEN FIRM PERFORMANCE GOES UP SO DOES PAY ...BUT MUCH MORE FOR THE CEO THAN FOR WORKERS

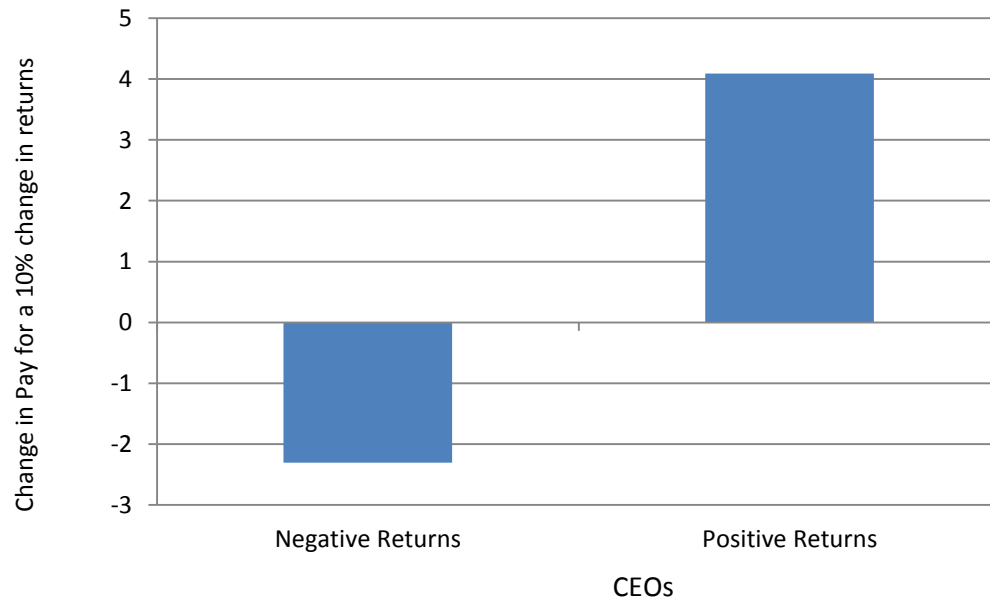


The effect of a 10% increase of Shareholder Return on total pay

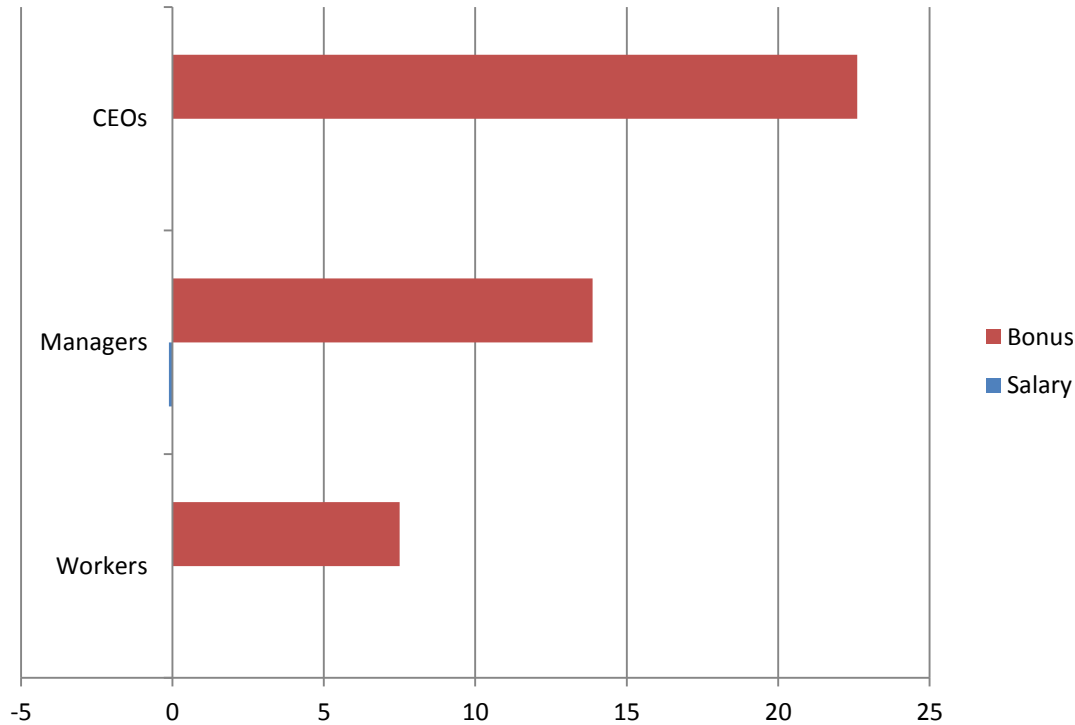
When shareholder return increases by 10% CEO pay rises by 2.8%.....but workers' pay rises by only 0.2%.

DO CEOS GET REWARDS FOR FAILURE? (2/5)

- Do CEOs get rewarded for the good times but not punished in the bad times? In our sample, shareholder returns are negative one third of the time.
- We find that CEO pay does fall significantly when firm returns fall. But some evidence that the pay-performance link is stronger in the good times



WHAT PART OF COMPENSATION GOES UP? IT'S BACK TO BONUSES..... (3/5)



- Only bonuses response to firm performance: no effect on salary
- A 10% increase in shareholder return means 7.5% higher worker bonuses – but bonuses only 5% of average worker pay

DO CEOS KEEP THEIR JOBS EVEN WHEN COMPANY GOES SOUTH? (4/5)

- Estimate the effect of firm performance on the probability of CEO exit
- If shareholder return doubles then CEO 7% less likely to lose job. There are no significant effects of returns on individual workers job loss.
- So there is an effect of performance on jobs, but not very big

MAGNITUDES: CEO VS WORKER PAY OVER THE DECADE (5/5)

- Average CEO pay up £969k to £1.48m 2001-2008, an increase of 53%
- Average worker pay £23.9k to £31.5k: 32%
- So CEO-worker pay ratio rose 41 to 47.
- The FTSE350 returned 35% over same period (real terms 20%).
- Predict that this increased CEO pay by 5%: accounts for 1/4 of increase in CEO/worker ratio. Other estimates might raise this to ~1/2
- Seems unlikely that performance can explain the recent additional spurt in CEO pay

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IS CEO PAY TOO HIGH?

- **Efficiency arguments**

- Positive link between CEO pay and performance (and has got stronger over time: was roughly zero in 80s/early 90s)
- CEO has more effect on firms than average workers implies there should be a tighter link between firm value and CEO pay
- Link is with bonus, most flexible part of package
- CEO pay falls when firm performance falls
- CEO firings increase when performance falls

- **Inefficiency arguments**

- CEOs better at grabbing “rents” than workers
- CEO pay doesn’t fall as sharply when performance dips
- The CEO firing-performance link is not so strong
- Performance accounts for less than half of increase in CEO pay

POLICY RESPONSES

- 50p tax rate – blunt instrument
- More disclosure on executive pay – increase the power of “say on pay”?
- Require Boards to show the link between pay and their firm’s performance
- European regulations have required more equity-based compensation in the financial sector – firms seem to have responded by increasing base salaries
- High pay not just CEOs – e.g. Top traders in financial services. Financial regulation & reform (see Bell & Van Reenen, 2010)