A say on pay

Will recent reforms to reporting on pay diminish the power of shareholders?

From June 2018, UK companies are going to have to publish more detail on the differences in pay between those at the top of the company and those at the bottom. Under the new rules, announced in August this year, about 900 publicly listed companies will have to disclose the pay ratio between bosses and workers in their annual reports and accounts.

Reaction has been typically partisan. The Trades Union Congress, for example, said that the raft of corporate governance reforms which was meant to increase the influence of workers within business has been drastically watered down. For example, the original proposal to mandate worker representation on corporate boards has been dropped.

Instead, businesses will need to ensure that staff can either nominate a director, create an employee advisory council, or assign a non-executive director to represent the workforce. This requirement is to be implemented through the UK Corporate Governance Code, which operates on a comply or explain basis. Companies that don't bother just need to explain why not.

While executive pay levels have fallen recently, the historical picture shows a steady disparity between those at the top and those at the bottom of companies. Businesses are fond of saying that they need to pay top rates to attract the most talented executives in a competitive global market. Twenty years ago, chief executives made about £45 for each £1 earned on the shop floor. Today, the boss earns £129 per every £1 a worker earns, according to research group the High Pay Centre.

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The bigger picture, though, is not exclusively about pay. Over the past 20 years, the shareholder model of capitalism has strengthened despite counter-movements that argue companies have a responsibility to a broad range of stakeholders. In the UK, the shareholder model is written into law so that directors have a duty to act in the best interest of their investors. How they pay workers is their own business.

Privately, many at the top of the largest financial consulting firms believe that the shareholder model has run its course. They argue it promotes risks associated with short-termism to the detriment of communities, environments, and workers. The expansion and emphasis on non-financial reporting initiatives that have seen businesses widen the extent of their public disclosure in areas such as board diversity and pollution all support this trend.

But others worry that, without radical change, the shareholder model will continue to reassert itself by other means. With constant investor pressure, the government's pay ratio reforms could force executives to embrace the letter rather than the spirit of the new rules.

For example, rather than cutting executive pay or increasing the salaries of their workers, companies may look at other ways of reducing the ratio. That could mean outsourcing jobs or increasing automation. The former has been one of the stories of the last 20 years; the latter most likely will be a major story of the next ten.

Risk managers have slowly been moving to look more holistically at the threats that could derail their businesses' strategies. Reputation risk arising from a wide range of issues now ranks as one of the top five executive worries – largely because it can destroy shareholder value. The power of a range of communities outside of corporations has been massively amplified by social media. Only time will tell whether those stakeholders will assert themselves over the shareholders who have called the shots during the past 20 years.

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