

Some observations on executive remuneration.

1. On bonuses

Why are bonuses restricted to executives? Because only *they* affect corporate performance, and other employees' performance doesn't matter? Or is it that they are the kind of person who is motivated by profit to work well, while other employees do a good job without incentives?

This is an empirical question: whether or not good work by executives requires bonuses. If so, is it due to the kind of person who takes an executive job, or the intrinsic nature of the job itself? Without knowing of any research on this, I suspect that it's probably not true that the executive or the job is so different from other employees or other positions. The influence of executives on a Company's result is also probably over-stated. Human nature is such that people like to think themselves more in control of events than they really are.

Be that as it may, the granting of bonuses to executives seems to be based on the assumption that their actions are a direct cause of corporate profit. For if corporate profit were not caused by the executive performance, then it would make sense to share any profit with all employees, or just with shareholders.

But supposing for the moment that there is a direct link, such that some fraction of corporate profit is attributable to executive performance, then since the profit is presumed to be caused by executive action, so must, *ipso facto*, any loss or deficiency also be thus caused. In which case, surely the executives responsible for the profit are also responsible for the loss, and they should be putting their hands into their own pockets to repay the Company the same fraction that they would have received in the event of a profit. In short, there must be negative as well as positive bonuses; otherwise it's just a racket; the deal is one-sided. And for one-sided deals why not adopt the policy satirised by Voltaire: "*dans ce pays-ci, il est bon de tuer de temps en temps un amiral pour encourager les autres.*" Sadly, it seems that human nature wants carrots for ourselves but sticks for others.

Not essentially different from the bonus is the call option, priced to reward the executive for a rising share price. But to be fair, the monetary value of the call option granted should be paid for by requiring the recipient to write a corresponding put option on the share price so as to suffer on the downside as well as benefit on the upside. Indeed, all bonus mechanisms must be similarly balanced.

Of course, in itself even-handedness does not solve the problem of short-term opportunism; that must be dealt with by other means.

In conclusion, I find distasteful the proposition that doing good work is like a donkey straining after a carrot. But if that mechanical and demeaning view of human nature applies in the corporate world, then as well as carrots, there must be sticks too!

2. On inequality

Much could be said on this topic; suffice it to say here that in an organisation with a large ratio between top and bottom wages, one suspects that the deleterious effects on employees documented by, for example, Marmot and Wilkinson, (2006), and socially more generally by Wilkinson and Pickett, (2009), will be far greater than one in which such a ratio is less. It scarcely needs pointing out that there are economic harms consequent upon inequality of wealth – too much investment and too little consumption.

3. On salaries

When there is a shortage of plumbers, nurses, accountants or neurosurgeons, the community through the Government takes steps to train more. This may take a few years, but when the numbers increase, wage pressure in that job category eases. Executives are also a product of training, usually on the job, often with some formal courses also undertaken. There is nothing magical about it. By training more people, salaries can be brought down to realistic levels and economic efficiency improved.

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1. Marmot M. and Wilkinson R. (eds): *Social Determinants of Health*, 2nd Edition. Oxford: Oxford University Press, 2006, pp. 376, ISBN: 9780198565895

2. Wilkinson R. and Pickett K., *The Spirit Level: Why More Equal Societies Almost Always Do Better*, Allen Lane 2009, pp 331, ISBN: 9781846140396