Reviewing executive remuneration decision-making and reporting: implications for theory and practice

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Abstract

Purpose:

The purpose of this viewpoint is to comment on the implications of the Financial Reporting Council's (FRC) Review and Consultation Documents expected to update regulation governing the determination/reporting of executive remuneration in UK stock market listed companies. Practical points from actors involved in executive remuneration decision-making/reporting are presented, set within the context of neo-institutional theory.

Design/methodology/approach:

Our qualitative research systematically analyses UK Corporate Governance Codes, the FRC's recent Review/Consultation, and peer-reviewed published studies of executive pay determination based on in-depth interviews with non-executive directors, institutional investors, executive pay advisers, and Human Resources (HR) professionals.

Findings:

Further regulation, while providing coercive influence over executive remuneration decision-making, is likely to lead to only limited change in processes and reporting due to benchmarking, the make-up of Remco membership and shareholders' preferences. Mimetic and normative isomorphic forces work against coercive isomorphism leading to resistance to change as decision-makers strive to safeguard their social status/reputations.

Practical implications:

Reviewing executive remuneration package components and paying attention to company strategy, sustainability and values in pay determination are welcomed but recognised as difficult to achieve. Drawing upon a wider range of information sources/voices can assist in broadening the discussion. HR professionals can help widen stakeholder input to executive remuneration decision-making.

Originality/value:

Our viewpoint is grounded in peer-reviewed empirical data that draws directly upon the views/experiences of executive remuneration decision-makers to identify problems in adhering to FRC recommendations for change. We extend the meta-theoretical perspective of neo-institutional theory – specifically institutional isomorphism – as providing explanatory and predictive power to understand executive pay decision-making.

Key words: Corporate governance codes; Executive remuneration; Institutional isomorphism; Qualitative research; Remuneration committee.

Article classification: Viewpoint

Introduction

The High Pay Centre (2023) reports that Chief Executive Officer (CEO) median pay in the Financial Times Stock Exchange 100 Index (FTSE 100) as 103 times the median full time worker's pay. FTSE 100 CEOs only had to work until 2pm on 5 January 2023 to overtake median pay for the UK full-time worker – nine fewer hours than in the previous year, underscoring the upward trend in CEO pay and widening pay differentials. While expert analysts might dispute claims over how the widening gap between CEO and full-time workers' pay is calculated (for instance, cashing out of options in a small number of firms can distort the picture), the public reads these headline figures and this generates a sense of unfairness and anger over perceived corporate greed, particularly when juxtaposed with media headlines on rising interest rates, energy bills and food price inflation hitting UK citizens. Executive pay is therefore an important issue that justifies academic commentary.

The Financial Reporting Council (FRC) holds responsibility for setting the UK's Corporate Governance and Stewardship Codes which include regulating executive pay of all companies listed on the UK Stock Exchange. The mechanics of determining executive remuneration are delegated to remuneration committees (Remcos) drawn from independent company board members (or non-executive directors – NEDs). Remcos have delegated responsibility for designing and determining remuneration and other employment conditions for the chair, executive directors and the next level of senior management (Perkins, 2017).

Current regulatory interventions, published in the UK Corporate Governance Code (FRC, 2018), instruct Remcos to recognise and manage potential conflicts of interest in the executive remuneration setting process. Remcos are told to focus on "the strategic rationale for executive pay and the links between remuneration, strategy and long-term sustainable success" (FRC, 2018, p.35). Given the controversial role played by incentives within executive remuneration packages (Edmans and Gabaix, 2016), Remcos are instructed to find ways to “counteract the risk of incentives that are detrimental to the long-term success of the company” (FRC, 2018, p.35). Remcos are “encouraged to be innovative and to work with shareholders to simplify the structure of the remuneration policy” (ibid., p.35), not only to enhance communication with the workforce and, given their statutory say-on-pay (SOP) obligations, with shareholders (Stathopoulos and Voulgaris, 2016), but also to reduce “reliance on external consultants” and “benchmarking to the market” (FRC, 2018, p.35). In that regard, it has been stated that “pay consultants may be centrally implicated in facilitating CEOs’ attempts to achieve overly generous pay settlements” (Ogden and Watson, 2012, p.502). [For details on the composition of top pay packages see Jones and Perkins, 2020, pp.341-389.]

The current UK Corporate Governance Code (FRC, 2018) is under review (FRC, 2022, 2023), with new regulation applicable to practice/reporting from the beginning of 2025. Understanding the implications of a new FRC Code that will influence the implementation of its recommendations is crucial. Yet, here lies a gap in our knowledge. While peer-reviewed literature reports on aspects of executive remuneration determination and presents these within various theoretical frameworks, the empirical research has not specifically been applied to a particular purpose in respect of actual practical contributions (such as in response to the determination of new regulatory structures). The theoretical lenses fail to provide an overarching approach to enable the explanatory and predictive power needed to determine how any new regulation might affect substance and processes.

This viewpoint therefore aims to address these practical and theoretical gaps by highlighting key executive remuneration issues raised by the FRC in its Review of Corporate Governance Reporting (FRC, 2022), supplemented by its Consultation Document (FRC, 2023). Our objective is to marry up the FRC’s suggestions for change with the viewpoints and practical experiences of key actors involved in determining and reporting on executive remuneration, grounded in our up-to-date, rigorously peer-reviewed, academic research (Perkins and Shortland, 2022, 2023; Shortland and Perkins, 2023a, 2023b). The paper's content involves interrogation of in-depth observations gathered from interviewing individuals that Pettigrew (1992, p.178) calls "network stars" actively involved in day-to-day Remco work in FTSE 100 companies. These are individuals who occupy multiple large company boardroom appointments, their specialist external and internal advisers, and those from the institutional investment community. They bring wide and varied experience of industry, regulatory and capital investment organisations and thereby inform our analysis. We stress that not only are these high impact decision-makers, but their upper echelon profiles, interconnections, and links with significant socio-economic institutions make them corporate governance agenda shapers (Perkins and Shortland, 2022). Drawing upon these sources, we present our viewpoint on how further regulation might (or might not) address corporate governance shortcomings in respect of executive remuneration in large stock-market listed companies.

Besides having a practical purpose, our paper also has a theoretical one. We set out to address the current theoretical mishmash by proposing a meta-theoretical good fit which offers potential to extend our understanding of executive remuneration determination. We argue that one overarching explanatory and predictive frame potentially offers a clearer route for those involved to assess how and why they act as they do. In essence, we argue that while theory can inform practice, practitioners require a 'go-to' framework that can help them to identify likely problems in enacting particular interventions such that appropriate action can be taken. We therefore review and refine the theoretical frames used in our previous empirical research to identify that neo-institutional theory provides a good meta-theoretical fit.

Background: corporate governance codes and executive remuneration

The Cadbury Report (1992) was the first UK corporate governance code. It addressed the role of the board of directors in ensuring integrity, transparency and accuracy in financial reporting. This was followed by the Greenbury Report (1995) which recommended that executive remuneration should be linked to performance and should be disclosed in a clear and understandable manner. Since then, executive remuneration has remained a key aspect of UK corporate governance. Since Greenbury, various iterations of the codes have sought to ensure that executive remuneration is aligned with the long-term interests of the company and its shareholders, and that it is transparent and understandable to stakeholders (Table 1).

TABLE 1 HERE

The latest version is the UK Corporate Governance Code (2018) (hereafter, the Code). It encapsulates principles as they have evolved over the past 30 years:

> "The Code does not set out a rigid set of rules; instead it offers flexibility through the application of Principles and through 'comply or explain' Provisions and supporting guidance. It is the responsibility of boards to use this flexibility wisely and of investors and their advisors to assess differing company approaches thoughtfully" (FRC, 2018, p.1).

The Code states that companies should have a remuneration committee (Remco) which is responsible for setting executive remuneration aligned with the long-term strategy of the company and in the interests of its shareholders. The Remco comprises NEDs and their appointed chairs, who can take advice from remuneration consultants who should be identified in the annual report. Remcos must exercise "independent judgement … when evaluating the advice of external third parties and when receiving views from executive directors and senior management" (FRC, 2018, p.13). Companies are required to disclose the details of executive remuneration determined by the Remco in a clear and understandable manner, including the total amounts paid, the performance metrics used to determine pay, and any other benefits or awards granted.

Shareholders play a critical role through their SOP powers (Lozano-Reina and Sánchez-Marín, 2020), and institutional investors are expected to represent the interests of shareholders with the ability to vote on key decisions at shareholder meetings. Institutional investors are typically large asset managers who invest on behalf of their clients such as pension funds and insurance companies. The Stewardship Code (FRC, 2020) encourages institutional investors to engage actively with the companies they invest in, to be transparent in their approach, raise concerns about corporate governance issues where necessary, and to exercise and disclose their voting rights in a responsible and informed manner. They should also collaborate with other investors in order to promote collective action on corporate governance issues. Institutional investors are expected to use their influence to monitor and hold companies to account for underperformance or poor governance practices including executive remuneration.

In 2022, the FRC published its Review of Corporate Governance Reporting (FRC, 2022), based on the assessment of 100 FTSE 350 and Small Cap companies (hereafter, the Review), and in early 2023, it began consulting on a revised code and accompanying guidance (FRC, 2023) (hereafter, the Consultation). The FRC (2022, 2023) sets out the focus of its revisions following the reforms that HM Government proposes to legislate for: directors' responsibilities for governance, internal control, and corporate reporting and responsibilities applicable to the preparers of financial and non-financial information (usually professional accountants), auditors and providers of assurance services, and actuaries.

Theoretical framing to offer a viewpoint on the FRC's Review and Consultation

Our peer-reviewed, published research on the corporate governance of executive remuneration (Perkins and Shortland, 2022, 2023; Shortland and Perkins, 2023a, 2023b) critically examines the effect of social interaction between the upper echelons (Neely *et al.*, 2020) involved in setting and scrutinising policies and practical outcomes from executive remuneration determination. To frame this viewpoint we draw principally upon the theoretical perspectives we employ in our research series. We acknowledge there is a range of theories used in discussing executive remuneration, most often concentrating on ways of aligning managerial and shareholder interests balancing the power of corporate enterprises' agents and principals (Perkins, 2015), and we support our critical review with relevant literature. In this section we examine the ubiquitous relevance of applying a neo-institutional meta-theoretical framework to the analysis of executive remuneration determination. We take this forward in our discussion to suggest that, contrasting with principal-agency theorising, this meta-framework is best suited to explain and predict likely outcomes from the FRC's (2022, 2023) Review and Consultation.

Crombie (2009, p.1) argues that "periodic reviews of corporate governance codes of best practice in most developed countries … tend to recommend the same set of executive remuneration policies". Mindful of such scepticism, we examine the influence of executive remuneration decision-makers' discretion (Perkins and Shortland, 2022), i.e., the extent to which outcomes lie within or outside their control, or somewhere in-between (Finkelstein and Boyd, 1998). We use this analysis to extend the explanatory power of DiMaggio and Powell's (1983) classic argument that over time environmental influences give rise to homogenising or 'isomorphic' tendencies, arguably exacerbated through regulation of decision-makers' scope to exercise discretion in completing tasks associated with Remco members' or institutional investors' accountabilities (Finkelstein and Boyd, 1998).

Coercive regulatory pressures may be viewed alongside normative pressures (such as industry standards) and mimetic pressures (such as imitating successful peers) as shaping executive remuneration decision-making and endorsement, prompting reliance on benchmarked recipes, say, for judging executive reward-performance alignment (Davis, 2017). There are risks that, where there is an information gap between executives and remuneration decision-makers, scrutiny is undermined. For example, safety-first isomorphism (Oliver, 2011) may encourage organisations to adopt certain practices or structures unnecessary for their success. Increasing normative compatibility with environmental characteristics (Cardona *et al*., 2020) undermines strategic differentiation as well as being resource-wasteful (Greenwood *et al*., 2014). Executives may use discretionary access to “private information” (Iatridis, 2018, p.33) for opportunistic manipulation of key financial numbers to satisfy analyst forecasts and investor expectations. There is a risk that algorithms, rather than judgement by Remco members or votes on corporate disclosures may, in effect, regulate executive pay outcomes to the detriment of other corporate stakeholders. In other words, what Brunarski *et al.* (2015) term regulation-compliant window dressing may weaken the effectiveness of initiatives such as the SOP rules (Baixauli-Soler *et al.*, 2021).

Below we unpack what strike us as key theoretically orientated issues emerging alongside the development of corporate governance regulatory developments. Our published findings offer insights which may be grouped under four headline themes: accountability, diversity, independence, and professionalisation. To understand the socially constructed processes executive pay decision-makers encounter in discharging their roles, we position these within the neo-institutional rubric of coercive, mimetic and normative isomorphic forces.

Accountability

The UK Corporate Governance Code makes explicit an expectation that decision-makers are publicly accountable for ensuring executive pay awards are linked to the delivery of strategy and long-term corporate performance (FRC, 2018). Accountability in general has been linked with expectations that actions by an accountable social actor will face scrutiny of what they do – with consequences. These may reward the individual by reinforcing their legitimacy, or they may carry sanctions adversely impacting on their personal reputations, with risks to their legitimacy. Foregrounding SOP processes so as to require decision-makers to account for their choices, but with the risks of algorithmic straightjackets and executive manipulation (Baixauli-Soler *et al.*, 2021; Iatridis, 2018), may be viewed as encouraging a view of accountability synonymous with punishing groupthink (FRC, 2014). The inference may be drawn that, given the reputational risks, the regulatory regime has given rise to a general sense of mistrust among all stakeholders, running counter to intended delivery of the strategy and positive long-term oriented outcomes the regulatory codes call for (FRC, 2018).

Given shortcomings in metrics generation alone to assess organisational behaviour under dynamic business conditions, we reason that, instead of a sanctions bias when theorising ways to regulate accountability around executive remuneration, the social actors involved might instead be encouraged to apply their discretionary potential to do the right thing, underpinned by a sense of socially grounded 'felt accountability' (Shortland and Perkins, 2023b). Our dialogue with decision-makers indicates application of their own values when determining executive remuneration offers a form of peer-networked quality assurance that also preserves upper echelons membership (Shortland and Perkins, 2023b) thereby suggesting normative isomorphic pressures come into play.

Diversity

Codified corporate governance calls for diverse views among executive remuneration decision-makers (FRC, 2018, 2020). This comes in the face of claims that it is narrowness in the social and professional circles from which Remcos and institutional investment firms constitute their members that undermines the likelihood that they will effectively moderate excessive pay expectations among those occupying corporate executive roles, as they are decision-makers' upper echelon peers (Perkins and Shortland, 2023). In day-to-day discourse, "most often what people are referring to when talking about diversity" is immutable, differences such as ethnicity and gender (Jehn *et al*., 1999, p.743). However, implicitly the UK Corporate Governance Code may be more balanced than such standard interpretations. It calls for appointments to boards/Remcos that, on the one hand, promote "diversity of gender, social and ethnic backgrounds", but also recognises "cognitive and personal strengths" (FRC, 2018, p.8). Adopting that more nuanced thinking leads to broadening theorisation of diversity beyond social category to incorporate informational and value-based diversity (Jehn *et al*., 1999).

Decision-makers may accept that executive remuneration determination will benefit from inputs beyond "the usual suspects" (Li and Wearing, 2004, p.359) but with diversity enhancement framed to avoid diluting the authority underpinning decision-making itself focused on achieving strategic and long-term performance goals. Upper echelons sources may be expected to continue informing executive remuneration decisions as effective governance may not be served just by appointing people who challenge existing social networks and value similarity, particularly given the risks summarised above when the social actors are held to account (Shortland and Perkins, 2023b).

Independence

It has been argued that the notion of independence has been fetishized as a compliance prerequisite within codified corporate governance; independence becomes an end in itself (Rodrigues, 2008). Regulatory initiatives to shift the balance of power from corporate executives to NEDs exercising independent judgement, advised by specialists also positioned at arm's length from the organisation, may be viewed as standing in conflict with the strategic human resource management functions of executive remuneration setting (Perkins and Shortland, 2023). A more nuanced theorisation of independence may be needed rather than blind acceptance that organisational detachment trumps the situated knowledge needed to avoid formulaic outcomes (Hersberger-Langloh *et al*., 2021). Situated or context-sensitive independence, where checks and balances around executive remuneration determination rely on decision-makers' capacity to know what's going on so as to mitigate against, for example, the private information risks identified above, may be more appropriate.

Decision-makers must ensure the design of executive remuneration aligns the interests of a company's executives with implementing key success factors for corporate strategy execution (FRC, 2018). Yet this comes with the challenge of those accountable being sufficiently confident in their capacity to explain nuanced, technically complex remuneration design, intentionally matched to situated, forward-modelled rather than homogenised benchmarks (Perkins and Shortland, 2023). This is especially so where perceived decision-maker error carries adverse reputational consequences tempting actors to acquiesce with decisions that are quasi-deterministic as well as strategically inefficient (Sydow *et al*., 2020). One risk associated with the consequences of independent, strategy-linked decision-making may be mimetic isomorphic approaches to executive remuneration determination.

Professionalisation

Once "a handy sinecure with which to end one's career" (Keogh, 2020, p.0), Remco members have become agents whose policies need to motivate executives towards delivering the company's chosen strategy (FRC, 2018), and pass scrutiny under a SOP regime (Lozano-Reina and Sanchez-Marın, 2020). Applying the notion of executive remuneration decision-maker professionalisation, balanced with narrative accounts given by those with front-line accountability for these roles, may help evaluate the merits of proposed further regulation intended to bring about improvement in who participates, their competencies and the processes followed, and to challenge normative isomorphism. Theorising professionalisation may usefully contrast institutionalising diversity and independence (Lynch *et al*., 2004) with self-interested homogeneity (Edwards, 2014) once challenges to decision-makers' reputations in contemporary institutional settings are factored-in (Shortland and Perkins, 2023a). Regulation-compliant professionalised window dressing (Brunarski *et al*, 2015) may carry unintended consequences not only undermining SOP but leading nominally arms-length decision-makers to stray into matters that are the preserve of executive roles. There is a risk of a dark side to the professionalisation of executive pay decision-makers: increased knowledge may lead them into the classic trap of mission creep (Shortland and Perkins, 2023a).

In summary, our view is that understanding the dynamics of codified corporate governance regulation to predict likely outcomes will be assisted by drilling down into demands to professionalise, make independent, diversify, and hold accountable the social actors involved. Adopting a neo-institutional frame of reference, refined over our series of published research outputs, helps theorise examination of the prospects for further executive remuneration regulation. We defend our choice of a meta-theoretical isomorphic framework as offering a comprehensive basis for understanding the role of institutional phenomena in the corporate governance of executive remuneration. Attention is needed to additional isomorphic tendencies, going beyond the coercive which threaten potential legal repercussions, because decision-makers' own reputations and their source of legitimacy as members of socio-economic upper echelons are at risk. Hence, such individuals are opened up to the lure of mimetic and normative forms of homogenisation.

Method

We set out to offer an informed perspective on the FRC's Review of the Code, contextualising this using our suggested meta-theoretical neo-institutional perspective as to the role that further regulation might play in helping to address corporate governance shortcomings in respect of executive remuneration in large stock-market listed companies. To aid replicability, we explain here how we did this, to provide the best available evidence.

We began by carefully reading the series of UK governance codes (Table 1) so as to understand the context of executive remuneration determination. We placed specific emphasis on the UK Corporate Governance Code (FRC, 2018) as this sets out current regulation and recommendations. We then focused our analysis on the FRC's Review of Corporate Governance Reporting (FRC, 2022) and key focal consultation points arising from this (FRC, 2023). We read all of these documents forensically, taking note of the key areas relating to executive remuneration; from these we noted those that the FRC listed as being: strategy; pay for performance; clawback provisions; pay ratios and workforce engagement; and shareholder engagement and approval. We structured our findings around these headings so that we could show an informed response to the issues of concern raised within the FRC's Review/Consultation.

As this paper takes the form of a research and practice viewpoint, we then drew upon up-to-date data published in 2022/23 from our own UK-based research (Perkins and Shortland, 2022, 2023; Shortland and Perkins, 2023a, 2023b) in order to comment on practitioner perspectives' on the issues raised in the FRC's Review/Consultation and to identify implications for practice. Full details of the method and data sources underpinning these studies are provided in these peer reviewed papers. We also used these papers to review potential theoretical frames that might explain practice and identify approaches to future research. First we set out our findings such that the FRC's identified shortcomings in current company practice which may drive its potential recommendations for change were highlighted. Then we followed up in each case by summarising what our sample of individuals actively involved in executive remuneration determination and approval said about these issues in order that we might extrapolate potential future practice. Our findings enabled us to then refine our understanding of the theoretical frames that can be applied in research into executive pay determination, leading us to suggest neo-institutional theory as a meta-theoretical perspective with good fit for further research (see Discussion).

Findings: Review of Corporate Governance Reporting and issues for executive remuneration

In this section we consider the Review's (FRC, 2022) findings on strategy, pay for performance, clawback provisions, pay ratios and workforce engagement, and shareholder engagement and approval. Additional emphasis in the Consultation Document's (FRC, 2023) commentary on remuneration is noted. For each of these we draw upon our empirical research to indicate NEDs', advisers' and institutional investors' views on their current and potential future practice.

Strategy

The Review reports concern over statements on aligning executive remuneration with company purpose and values, and links with successful delivery of long term strategy. Greater clarity, transparency and improved quality of disclosure backed by specific supporting information are called for.

Our findings indicate that those involved in executive remuneration decision-making support its alignment with strategic objectives. Indeed, Remco members express concern that their decisions reflect organisational specifics and are critical of comparisons with different organisations. Notwithstanding this, external advisers comment on off-the-shelf benchmarking as having a "problematic influence" leading to "unintended consequences" particularly through the loss of sight of the link between executive pay and strategic objectives (Perkins and Shortland, 2022, p.621). They note that Remco chairs can receive benchmarking data passively rather than challenging it and risking controversy through non-standard approaches (Perkins and Shortland, 2023). Internal HR advisers also see a strong focus on the use of benchmarking data rather than more creative solutions. A further problem identified concerns the limited time that Remco members have, when working across a range of organisations, to understand the specifics of each so as to add value (Perkins and Shortland, 2023).

Institutional investors also recognise the lack of differentiation in approaches to executive remuneration (Perkins and Shortland, 2023) and seek stronger alignment between strategy and incentive arrangements. Yet, they are mindful that they can be partly to blame for standardised outcomes; they admit to being unwilling to "assess company investments through bespoke rather than generic follow-my-leader metrics" because shareholders are not prepared to risk the creation/development of bespoke metrics, preferring instead comparator metrics (Perkins and Shortland, 2022, p.625).

Hence, while the spirit of Remco decision-making appears to favour aligning executive remuneration with strategic objectives, this can become "irreconcilable" with the "inevitable multiple views of those holding the business within their investment portfolios". To counter this, institutional investors call for Remcos to follow a strategic path but to "be willing to take responsibility for justifying it" (Perkins and Shortland, 2022, p.625). Here, internal HR advisers believe they can make a difference – they say that their organisational insight can be used in briefing Remco members such that they gain greater strategic understanding (Perkins and Shortland, 2023).

Pay for performance

The Review finds that statements made about remuneration structures/performance measures in the main lack explanation of the rationale chosen for annual bonuses and/or long term incentive plans (LTIPs). The Review calls for company reports to explain performance pay rationales (including weightings and target achievements), their link to strategy and performance indicators, and how these translate into granted awards.

Our findings suggest that while respondents accept the need to work within governance norms, there is a view that transparency creates more problems than it solves and can lead to the politicisation of executive remuneration. Market inflation in executive remuneration flows from various factors including the competitive environment, off-the shelf benchmarking and Americanisation of executive pay (Perkins and Shortland, 2022).

NEDs emphasise that a rebalance between basic and performance-related pay is needed, although they recognise this presents inherent difficulties as remuneration should reward “real, measurable achievement”. Institutional investors concur – they find executive remuneration determination to be “over-complicated, over-biased towards incentives”, noting that “such arrangements fail in their espoused roles when generally regarded as less a function of executive agency and more the vagaries of extraneous forces”. Even advisers who potentially have a “vested interest in complexity in the area of their expertise” see problems in aligning performance across time horizons with reward that differentiates the average from the exceptional (Perkins and Shortland, 2022, p.626).

Advisers report the irony of simplicity (and being closer to cash) with fewer performance conditions, presenting a more valuable executive remuneration programme (Perkins and Shortland, 2022). With respect to linking performance-related pay to corporate strategy, dialogue with a variety of corporate voices is needed such that sufficient information and relevant metrics are available to inform judgement but here the emphasis is on whether executive remuneration outcomes feel right. Clear and detailed explanations of performance pay rationales appear problematic. As institutional investors explain, financial value needs to be delivered to clients in the short-term but this has to be balanced against sustainable firm performance leading to complexity not only in determining pay for performance but also in communicating decision-making in this regard (Shortland and Perkins, 2023a).

The Review welcomes remuneration metrics linked to environmental, social and governance (ESG) and diversity targets but notes that these should be linked to company strategy. The Consultation Document strengthens this with a specific focus on long-term sustainable success. The Review encourages companies to consider board diversity, taking account of its benefits.

Our findings suggest that while shareholders might want to see excellent ESG credentials, it is difficult to balance rewarding executives against these and with company performance as metrics need to take account of social responsibility, sustainability, environmental factors and shareholder returns. The application of personal values is considered helpful in determining appropriate, socially acceptable, levels of executive remuneration linked to decision-makers' personal ESG credentials (Shortland and Perkins, 2023b). Involvement of the HR Director in briefing Remco members is suggested as a means of providing information on relevant issues (Perkins and Shortland, 2023).

With respect to diversity, our findings suggest that those involved in executive remuneration decision-making see the inclusion of minorities as positive (Shortland and Perkins, 2023a) but to ensure the smooth functioning of Remcos, membership drawn from similar social networks and value sets is preferred. Notwithstanding this, informational diversity (such as contributions from the HR function) can help to moderate a lack of diverse viewpoints (Shortland and Perkins, 2023b).

The Review notes that although many companies did highlight their discretionary powers, for example, to cancel or reduce the amount of bonus or LTIPs awarded (say, when targets are not met, fines are faced, or company/industry performance is poor), the level of detail given varies. It calls for companies to disclose clearly the use of discretion within their annual remuneration report, noting that it should highlight the factors involved, why discretion is needed, and provide detail on the adjusted remuneration outcome, so that investors and other stakeholders can be assured of appropriate final remuneration outcomes.

Our findings (Shortland and Perkins, 2023b) show that Remco members believe it to be very difficult to undo a package that has been offered contractually, particularly when targets have been achieved. Notwithstanding this, institutional investors say that they encourage Remcos to use discretion to reduce pay linked to company circumstances recognising that this can act as a brake on excess. They suggest repurposing standardised metrics such as total shareholder return (TSR) and earnings per share (EPS) as moderating mechanisms, particularly in the case of bottoming share prices and health and safety failures (Perkins and Shortland, 2022).

Our findings also suggest that decision-makers say that excessive LTIPs do not necessarily motivate executives. Remco members therefore suggest that a smaller but more direct link to company outcomes could be a more effective way of addressing performance conditionality. They note that performance-based recognition should be aligned with shareholder interests rather than be designed with forward-facing pay-outs (Shortland and Perkins, 2023a). However, the use of discretion in determining the final pay outcome rather than adherence to the agreed formulae can lead to unstructured pay outcomes. This is seen as an "unintended consequence" of trying to control excessive pay for poor performance (Perkins and Shortland, 2022).

Clawback

The Review finds that although most companies do set out their conditions on malus and clawback, these are only limited in use. Nonetheless, the FRC is encouraged by companies including reputational damage or failure of risk management within these provisions. It is important to note that one of the key stated foci of the Consultation Document's revisions concerns strengthening reporting and increasing transparency on malus and clawback arrangements.

Here our findings indicate that NEDs are concerned about the contractual nature of the relationships between CEOs and their companies alongside any definition of performance and its link to company outcomes if packages are to be undone (Shortland and Perkins, 2023b).

Pay ratios and workforce engagement

The Review finds that very few companies disclose how they explain the alignment of executive remuneration with wider company pay policy through workforce engagement. Notwithstanding this, there is improvement in the numbers stating that they engage with their workforce on executive remuneration policies, although many do so via current engagement methods. It notes that better practice is to hold dedicated meetings on executive remuneration and go beyond simply explaining the policy to elicit feedback by using two-way dialogue. More generally it notes that there is no evidence of "an increase in companies choosing to appoint a workforce director to the board" (p.23) and so the potential effectiveness of this approach, for example in influencing pay ratios, cannot be assessed. The Consultation Document emphasises strengthening reporting on pay gaps.

Our findings indicate that decision-makers see market forces as having driven up executive remuneration but say that the introduction of pay ratios to reduce CEO and workforce differentials are problematic. They believe that emphasis instead should rest on the alignment of executive remuneration with strategy, culture and values, the appointment of the right talent and appropriate performance conditionality (Shortland and Perkins, 2023b). Nonetheless, reflecting on the perceived fairness of executive remuneration outcomes, NEDs believe that recipients should be sensitive to public perceptions. Institutional investors are conscious of social attitudes in the UK to perceived pay excesses compared to other countries where they hold portfolios and advisers note the disconnection between practical administration and the moral outcomes of executive remuneration decision-making (Perkins and Shortland, 2022). Commenting on this, HR respondents note that NEDs need to be sensitised to how domestic and international stakeholders perceive the decisions taken and institutional investors suggest greater professionalisation of Remcos given the politicisation of executive pay (Shortland and Perkins, 2023a).

With respect to workforce engagement, our findings suggest that institutional investors and some NEDs recognise the benefits of involving management, including HR, to gain a stakeholder perspective. HR advisers can connect with executives and senior management to gain consistency in approaches to remuneration. HR can also work with internal and external specialists such as the company secretariat and legal functions. In this way HR say they can ensure an appropriate reporting narrative (Perkins and Shortland, 2023).

There is no appetite amongst our respondents for the appointment of employee representatives/worker directors to the board or their involvement in Remco decision-making. The view is that this will dilute the unitary nature of the Remco and be counter-productive through serving the interests of specific factions rather than the interests of shareholders (Shortland and Perkins, 2023b). However, HR can act as a conduit to help NEDs understand workforce perspectives (Perkins and Shortland, 2023).

Shareholder engagement and approval

The Review notes that very few companies report explicitly on shareholder engagement and how feedback received is considered, with its impact on remuneration policy and outcomes explained (for instance, in determining variable remuneration linked to targets and the use of discretion). Generalised statements that allude to considering shareholders' views do not provide explicit commentary on how shareholder engagement takes place. Thus, it finds room for improvement on shareholder engagement and its reporting, particularly on how the

Remco considers and reports on shareholders' feedback in drafting the remuneration policy/determining remuneration outcomes. It recommends increased transparency, with disclosures providing clarity on engagement timings, how the engagement takes place and who conducts it, such as the Remco chair meetings with major shareholders to discuss remuneration outcomes, not just policy.

With respect to shareholder engagement, our findings suggest that potentially more of this two-way dialogue takes place than is actually reported. NEDs spoke of the considerable level of conversation ahead of meetings, with Remco chairs, other NEDs, and also with institutional investors. Institutional investors also report active engagement with the companies they invest in, interacting with board members, lead independent directors and/or relevant committee chairs, and note that this engagement is in sufficient detail to inform voting strategies. However, institutional investors say they need to prioritise these interactions given the breadth of their portfolios but welcome high quality holistic exchanges, placing particular value on building confidence and trust in these interpersonal processes. Advisers also note that in recent years committee members have shown greater engagement with others thereby informing policy (Shortland and Perkins, 2023b). HR reports that the Remco report to shareholders is typically led internally with significant discussion behind the scenes to ensure that independent reports provided to Remcos are nuanced alongside relevant information of industry trends and practice (Perkins and Shortland, 2023).

It is notable that the Review states that more than 70 companies "faced a 20% vote or more against one of the remuneration-related resolutions at their [Annual General Meeting] AGM" (p.51). It suggests that discussion with shareholders ahead of the vote might have averted this and thus recommends that Remco chair seeks regular engagement with shareholders throughout the year.

Our findings indicate that institutional investors recognise companies and Remco chairs are “more conscious now about keeping shareholders on side” (Perkins and Shortland, 2022, p.623). However, institutional investors seek more searching and contextualised communication, rather than more meetings. Advisers echo this, noting that NEDs should be better informed of the context of executive remuneration and likely public scrutiny of their decision-making (Perkins and Shortland, 2022). It is suggested that while Remco chairs must maintain independence, and stay abreast of market and regulatory issues, they should interact with a variety of organisational voices to inform dialogue. Internal HR advisers suggest that the HR lead and the Remco Chair might surface contentious issues in confidence with the CEO to iron these out ahead of formal meetings and thereby also help to address ethical and moral aspects of Remco accountabilities (Perkins and Shortland, 2023).

Discussion

Implications for theory

Using a wide range of different theoretical perspectives does not easily provide the solid ground needed to offer the explanatory and predictive power required to understand what is going on within the black box of executive remuneration governance processes, and to bring changes into effect that will result in difference. This viewpoint paper has identified that deploying neo-institutional theory, specifically institutional isomorphism, to provide an integrative meta-theoretical perspective can provide an excellent fit for researchers to study executive pay determination and to assist practitioners to understand why regulatory change may not moderate excesses deemed egregious in the public eye. Framing executive pay issues through the lens of institutional isomorphism (DiMaggio and Powell, 1983, 2000) helps in grasping that, due to external cultural and political forces institutionalised to create the environment in which an organisation operates, self-interestedly professionalised decision-makers will tend to adopt the practices of others in whose orbit they too exist, to help retain their legitimate peer status within upper echelons.

We move the scholarly conversation on by unpacking institutional isomorphism thematically using four complementary concepts: accountability, diversity, independence and professionalisation. Each one surfaces as considerations shaping codified expectations to direct decision-makers in exercising their discretion (Finkelstein and Boyd, 1998). A critical reading of the theoretical construction of these concepts, not simply accepting standard representations in the literature, may help counter safety-first blind isomorphic conformity (Oliver, 2011) whether coercive, mimetic, or normative, while integrating them as a go-to source can help inform policy making and implementation.

Applying the meta-theoretical perspective, we evidence that institutionalised pressures carrying quasi-legal and reputational sanctions for non-compliance will lead executive pay decision-makers to adopt and apply policies for which they must publicly account consistent with those of others also subject to the codified regulatory regime. If they are not ensnared by coercive isomorphism, they will feel equally drawn to demonstrate independence and professionalism by conforming to the norm due to receiving advice and information through advisers and fellow members of the decision-making community that implies that they should mimic best practice comparators and/or follow consistent normative principles. Such analysis should not, however, risk overlooking decision-makers' discretionary potential (Brunarski *et al.*, 2015) enabling them scope to interpret coercive regulations, best practices and normative values in relation to executive pay in ways that may vary depending on the priorities of the group of people involved and the circumstances of their organisation interpreted consistent with the character of their informational diversity and values-informed felt accountability.

Implications for practice

Proposed revision to the Code includes actions to achieve better alignment between executive remuneration and corporate strategy. This implies the need for variation, not homogeneity, between practices implemented and sanctioned by decision-makers. Our findings illustrate instead a tendency towards risk avoidance: decision-makers' reliance on external benchmarking and boilerplate templates "continuing to trump attention to internal trade-offs relevant to more strategic decision-making" (Perkins and Shortland, 2023, p.424). Regulators instead might wish to focus on encouraging decision-makers to secure company-specific intelligence from internal advisers to enhance Remco members' knowledge. In turn, this could lead to greater strategic alignment, flowing through into Remco disclosures.

Leading on from this, proposed revision to the Code includes enhancements to the way executive pay for performance is reported to provide greater detail on strategic alignment of performance indicators and their translation into annual bonus and LTIP awards. Relatedly, active attention is required to diversity and ESG/sustainability targets within corporate strategy linked to reward outcomes. In each case our research shows how the Code's designers might acknowledge the balance decision-makers have to strike between rewarding executives linked to company performance while also accounting for social responsibility, sustainability and environmental factors. Decision-makers' complain that performance pay arrangements are overcomplicated and hard to explain, with a bias towards incentives, and where perverse consequences of transparency seem simply to reinforce executive remuneration politicisation. Once more, room is needed to introduce leeway that permits decision-makers to be exercise discretion with an institutionalised sense of legitimacy, to make necessary internal trade-offs. In return, detailed explanation may be called for under the revised Code as, by definition, a departure is needed from the constraints of a normative institutional straitjacket.

Issues around the exercise of discretion by executive remuneration decision-makers (Finkelstein and Boyd, 1998) are highlighted by the FRC. Our findings illustrate the need for institutional innovation: revisiting assumptions on the merits of forward-focused executive incentives. We find that decision-makers struggle with demands to renegotiate reward outcomes de facto baked-in to executive directors' contracts. The problem intensifies when linked with LTIPs, which are viewed as a rather blunt motivational instrument. Explaining practice becomes even more complicated by the vagaries of clawback and malus. This is particularly so where there are risks that executives' privileged access to information distorts the evidence decision-makers use for their adjudication (Iatridis, 2018), and where compliance may be more de jure than de facto (Brunarski *et al.*, 2015), undermining the spirit of SOP disclosure expectations (Baixauli-Soler *et al.*, 2021). This requires removing the coercive isomorphism trap of large forward-facing pay promises in favour of after-the-event recognition of evidenced performance outcomes, so mirroring investment returns to shareholders. Standardised metrics such as TSR and EPS indicators need to be repurposed as mechanisms which decision-makers can use if they are to be confident that these are codified as normatively sanctioned, particularly in the case of extraordinary ESG-type shortcomings.

The FRC also seeks to extend its regulatory focus over pay ratios disclosure and workforce engagement (given perceived disappointing compliance to date with the spirit of the Code). Our findings suggest widespread acknowledgement of the market upward ratchet, due to mimetic isomorphism. On the one hand implications may be in synch with FRC proposals to put the emphasis on internal strategy and performance linkages, provided the trade-offs described above are made, easing the pathway to compliance and explanation – not one or other. On the other hand, implications suggest strengthening codified encouragement for boards overall to increase their sensitivity in the direction of a more diverse approach to executive remuneration. Here, while there is no appetite for worker directors, encouragement to reinforce the value of representative inputs (such as those from the HR function) to help inform decision-making on executive pay, its justification, and its wider reception among stakeholders, appears to be welcomed as something the revised Code might institutionalise.

Finally, reinforcing the expectations that shareholders exercise their SOP mandate, our findings indicate that regular and continuous interaction between board decision-makers and institutional investors may be more widespread than is normally publicised. Notwithstanding this, there are calls by investment bodies that might be codified to expand company representation beyond CEOs and Investor Relations personnel so that Remco chairs get a seat at the table at informal board-shareholder interactions as well as at AGMs. Institutional investors also recognise the need to widen participation within their own organisations too, perhaps something the FRC might incorporate into the Stewardship Code (FRC, 2020). The key point is that such interaction offers scope for genuine explanation of context, facilitating executive remuneration decision-makers' confidence in pay policy and practice choices wherein the bespoke – rather than the normative, risk averse/safety first fall-back – will be reputation enhancing, not threatening.

Study limitations and future research agenda

There is the potential for bias in relying on our previous publications for the empirical data used, but it is important to note that all our studies have been through rigorous peer-review processes, have met the test of acceptance by a range of academic experts, and are published in academic journals holding starred rankings. We also stress that this paper is presented as our viewpoint and should be read in this context.

Future lines of research could benefit from taking forward neo-institutional theory as the preferred framework for analysing executive pay determination. We suggest this for two main reasons. First, if regulatory intervention is to achieve its goals, those responsible for policy-making need to understand how theory predicts outcomes. Being presented with a range of theoretical approaches suggests contradiction and lack of clarity in terms of what practitioners should consider. One key over-arching theoretical framework is more likely to become the go-to approach if it can offer practitioners both explanatory and predictive power. Neo-institutional theory does just that.

Our second point, related to this, is that while the publication of academic papers typically demands that implications for practice be highlighted, the extent to which these are read, let alone be taken on board by practitioners, is a moot point. We suggest that if one key theory is distilled from what is published and receives sufficient publicity, it can reach and be adopted by the practitioner community. And, given the very nature of isomorphism, the use of this selected theory (in this case neo-isomorphism itself) is likely to copied and disseminated via professionalised networks and thereby gain traction.

Our final point concerns the linkage between academics and practitioners. As Simsek et *al*. (2018, p.2021) note, academics are concerned that their research “has little practical impact”. We believe that robust research conducted by academics in association with the practitioner community involved in executive pay decision-making presents a win-win scenario. It can present academics with access to data for their research as well as an avenue to be viewed as relevant to practitioners; for practitioners, an academic partnership presents the opportunity for robust, theoretically-framed research and suggestions for practice tailored to their needs. In this regard, we suggest that policy-making bodies, such as the FRC, work with academics and consider neo-institutional theory in order to explain problems and deficiencies in current executive pay practice and to help to identify workable avenues for future action.

Concluding comment

Our paper set out to consider how further regulation might address corporate governance shortcomings in respect of executive remuneration in large stock-market listed companies. In short, rather than assume that further regulation to coerce executive pay decision-makers to act in prescribed ways, only reluctantly diverging if reputationally safe explanations can be offered, we suggest that the FRC may wish to pay attention to institutionally embedded factors surfaced in our recent research series reviewed in this viewpoint.

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Table 1: Summary of the evolution of UK Corporate Governance Codes

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Cadbury Report (1992): This focused on the role of the board of directors in ensuring the integrity of the financial reporting process and the importance of transparent and accurate financial reporting (Cadbury, 1992).

Greenbury Report (1995): This built on the Cadbury Report and focused on executive pay and the role of remuneration committees in determining executive pay (Greenbury, 1995).

Hampel Report (1998): This consolidated the Cadbury and Greenbury Reports and expanded the scope of the codes to include social and ethical issues such as environmental impact, stakeholder engagement, and the board's responsibility to consider employees' interests (Hampel Committee, 1999).

Turnbull Report (1999): This focused on risk management and internal control systems, requiring boards to identify and manage risks in a systematic and effective manner (Turnbull, 1999).

Higgs Report (2003): This focused on strengthening the independence of non-executive directors and ensuring that they are able to provide an effective challenge to the board and executive management (Higgs, 2003).

Smith Report (2003): This focused on improving audit quality and ensuring the independence and effectiveness of auditors (Smith, 2003).

Combined Code (2003): This brought together the various codes and reports into a single document and provided guidance on the roles and responsibilities of the board, the importance of risk management and internal control, and the need for transparency and accountability (FRC, 2003).

UK Corporate Governance Code (2010): This replaced the Combined Code and introduced new provisions on board composition and diversity, remuneration policies and practices, and the role of shareholders in engaging with companies (FRC, 2010).

UK Corporate Governance Code (2014): Applying to accounting periods beginning on or after 1 October 2014, this called on companies to monitor risk management and internal control systems and review their effectiveness at least annually, and report on that review in the annual report (FRC, 2014).

UK Corporate Governance Code (2018): This most recent version places greater emphasis on the role of the board in promoting the long-term success of the company, and on the importance of stakeholder engagement and culture. It also includes new provisions on the independence of the chair, the need for boards to have a diversity policy, and the role of remuneration committees in promoting company culture (FRC, 2018).

UK Stewardship Code (2020): This is described by the FRC as setting high stewardship standards for those investing money on behalf of UK savers and pensioners, and those that support them. It is complementary to the UK Corporate Governance Code for listed companies and, like that Code, is expected to be applied on a 'comply or explain' basis (FRC, 2020).
