Erasmus Management Lecture 2013

Regulation of executive compensation: Should shareholders get involved?

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Shareholder Spring

My topic is built upon what is an evolving shareholder movement. You all know about the Arab Spring, which is in fact still continuing to spill out in its consequences. But 2012 was cleverly called the Shareholder Spring, because there were uprisings at many companies. A lot of this was focused on Europe, maybe the UK more than other places.

There's a new dynamic, where shareholder rights and power to control managers have changed the balance of power in corporate governance. I'm going to talk about how this has played out in the area of executive compensation.

It's a story that has evolved over 10 or 12 years, with some early steps taken by the British that were then built on by some other countries. But at this point, you're in a position where the laws have become more and more aggressive, in my opinion less and less well-thought out, to the point that many of the steps being taken are not only counterproductive, but in my opinion just flat-out unworkable.

I think that this is likely to become an area where shareholders maybe are too involved. Unintended consequences are likely to occur to the regret of many folks. This is the argument I want to make in steps.

Case of Daniel Vasella

A useful point of reference is the Novartis retired Chairman Daniel Vasella. I think many of you know that his retirement agreement that was made public just a few months ago, caused a degree of outrage in Switzerland, and [...] helped spark a very positive vote in favour of a national constitutional amendment that I want to talk about in some detail. [...]

He was in office for more than 20 years, first as the CEO and then later as both CEO and Chairman. He was involved in the merger that created Novartis. He's married to the niece of the former Sandoz Chairman.

Now, as Vasella retires, it's announced that he will get a package of 12 million Swiss francs per year for six years, to essentially do nothing - to be available for consulting advice - but he's more or less being paid to leave quietly, and this becomes public in February 2013.

Many people regretted this contract almost immediately - I think in fact everybody but Vasella himself. The board miscalculated, the way it was publicised was probably not the best way, and they characterise this as a non-compete agreement, as though he would actually go work for another drug company when his wife's family has a long connection with Novartis. The whole set of arrangements were basically pretty preposterous.

But, on the other hand, if you peel back what's really going on here, I think they're just paying him to leave quietly. This is what we call a golden handshake in the USA, where a manager - he's only 59 - is personally not ready to retire, but they want to easily show him a way out the door. These things are

generally welcomed by shareholders in the USA, because you're solving a problem - which is getting a controversial CEO to leave in a way that will not make trouble.

This becomes a national political issue, not only in Switzerland but all around the world, where people debate about executive pay. This was held up as an outrage, as a symbol of the mistakes that are made, and I think it begs the question of why this really goes beyond Novartis itself. Why should politicians, why should the public at large care if Novartis makes a mistake and gives a bad contract to the CEO? You might think that there are other things that are even more important at Novartis, like: what are they wasting on bad drug procedures in the lab or building their grand headquarters outside of Basel? There are bigger ticket items that frankly are more important to the firm and could waste even more money than this bad contract, but for some reason the public takes a much greater interest in executive pay than other things.

Public issues

[...] Many people say that executive pay is basically a private matter between the firm and the manager, and that firms should be left to make their own mistakes and choices in this area. But I think it's not too hard to point to a number of public issues that quickly spill out of this.

Taxation

Taxation is obviously one of them. A lot of executive pay is transparently structured to avoid taxes, and when executives don't pay taxes, it means the rest of us have to pay a little bit more. So much of the regulation that you see in around the world is tax-driven, to make sure CEOs don't avoid taxes by deferring compensation or calling it performance pay when it's really not, and so forth.

Wage and price inflation

Executive pay can also be an aspect of wage and price inflation. There have been a number of times in the USA when we've had direct price controls to try to limit the growth of executive salaries, as part of a broader strategy to control wage and price inflation throughout the economy.

Convexity

Much of the recent criticism, though, focuses on a third point: compensation tends to be convex with respect to the underlying performance measure. In particular, if you pay people with stock options, the rewards get steeper as the firm performs better, and this encourages risk-taking.

The narrative that we often hear about the Financial Crisis is that, essentially, incentives in many banks were too good and that the managers took too much risk, crashed their banks, and then the negative externalities from this spilled out into the entire economy - jobs were lost, firms filed for bankruptcy. The whole bundle of things that went wrong is very often traced back to incentives that were too convex - where CEOs took too much risk.

This is not a new story. We also heard it 10 years ago after the big fraud scandals at Enron and WorldCom [...] and even back in the 1980s, which was the age of hostile take-overs and aggressive restructuring in the USA. [...]

I don't think a lot of this is correct. A lot of this analysis is simplistic and lacks support in the research. But nevertheless, the argument is at least internally consistent. It's something that could be the basis for regulation and I think in fact has been.

Personal envy

The public really care about a fourth point: there is an enormous degree of personal envy that seems to enter into this discussion. When somebody like Vasella is paid 72 million Swiss francs at a time when he's no longer wanted in the position, [...] people are outraged because they're not being paid 72 million to leave their own jobs. The basis for the regulation that is often introduced in national parliaments and […] of a lot of shareholder activism, [...] ignores some of these reasonably legitimate arguments and just boils down to the question of envy. We, as a society, don't want to put ourselves in a position where certain people make so much more than others. There's a certain value system that this seems to deviate from. Because of that, we need to find a way to fix this - to level the set of outcomes, so that no one person appears to get away with too much.

As an economist, I have a hard time with this. We frame things in terms of optimisation, marginal first order conditions, clearing markets, and so forth. Greed is something that we don't accept or reject, it's an assumption that everybody would like to have more. It's hard to tell what the overall distribution should be, but it probably shouldn't be equal for everybody. But the dynamic - and I see this especially in the vote in Switzerland recently - was to enforce a system of social values [...] It's not so much an economic argument, as one about human values - that is a little bit beyond what we tend to study and implement.

Say-on-pay in the UK

In terms of regulation, […] the kinds of things that are happening now start quietly in the year 2002, when the first say-on-pay regulation is introduced in the UK. At the time, I thought this was actually a very good idea. [...] It was a simple vote that would be taken every year at the annual meeting, where shareholders would vote on the overall compensation strategy of the firm, based on a certain amount of disclosure that would become mandatory. Basically, companies would have to produce information, and then the shareholders would vote on whether they liked the report they had received, or not. That would be it.

If you lost the vote, if the company didn't get at least 50 per cent, there was no direct consequence, apart from embarrassment. [...] The belief was that companies would implicitly do the right thing if they lost the vote, but there was no mechanical set of procedures that would kick in. Most importantly, the managers could continue working and being paid. This wouldn't immediately disrupt contracts that had already been agreed to.

In practice, these votes were benign. In fact, people were surprised that, despite a lot of public anger about executive pay, very few cases emerged of shareholders failing to ratify individual companies' packages, usually by overwhelming margins – 90 per cent or more.

This was the basis of some academic research, but I think that the lesson learned was that a few outliers seemed to drive the anger, but if you looked at the median company, or 90 - 95 per cent of the companies, shareholders are happy about how things are going.

Still, there were exceptions. The case that everybody remembers as the focal point is the Royal Bank of Scotland. During the Financial Crisis, the UK government effectively nationalised this bank and became a major shareholder, because it was one of several banks that had bought too many mortgages and had ended up more or less insolvent. They pushed out the CEO, Sir Fred Goodwin, who was entitled to 693,000 pounds per year for life, as a pension that had been previously agreed to. This was a contract, that, like Vasella's, everybody regretted, but the ink was dry; the deal was done. Shareholders, in a rare case, voted against the overall compensation strategy of the firm, but Goodwin was extremely defiant. He said, "I'm keeping my money, there's nothing you can do about it." The government threatened to

strip him of his knighthood, but ultimately, he cared about the money and there was nothing they could do. People thought: this law needs more teeth. If we want this vote to mean anything, we need to think about enforcement. We don't want a guy like this walking away, crashing a firm, and then taking a lifetime pension that he may collect for 30 or more years.

But I think cases like this are exceptional. They tend to focus a lot of the public attention, but the outcome in more benign situations was that better communication took place. This really happened in two dimensions: that the board had to produce a more thorough disclosure, and frankly, I think that forcing the board to do that work and to think internally about its own arguments and justifications for compensation improved contracting in British firms [...].

Then in the rare cases that votes failed or came reasonably close to failing, you would see people sit down and talk about it. Major pension funds and other institutional investors would meet with management; they would reconsider certain severance packages. Basically, this would have the effect of raising a red flag for certain companies, and the outcome was probably good for everybody, except maybe the managers: better contracts would take place in an environment that was informal and that would phase them in over time without disrupting the firm.

Adoption in other countries

Other countries began to take up the idea. It's hard to make up a complete list, because this has begun to happen so fast. The Netherlands was actually, to the best of my knowledge, the second nation to implement this, followed by many of the Nordic countries, the USA not until 2011 - this was ultimately included in the Dodd-Frank Act in the USA after a lot of debate - and took effect just two years ago. Germany and Canada have had an opt-in regulation, where some firms have chosen to do this, and then there's a much longer list of countries that have either begun to introduce this or may already have at this point. You now see well over half of the countries in Europe and some of the major economies around the world - Australia, the USA, Canada and some others - have adopted this with basically increasingly strict and aggressive limits, and this is really what I want to focus on. The British scheme worked pretty well, and probably led to more responsible behaviour. But these rules have now become mandatory in many countries, and what the meaning of mandatory is - what the consequences are if you don't get approval - has become more and more severe, to the point, as we will see in a minute, in Switzerland they're actually going to have criminal penalties where people could go to jail.

Data for the USA - now that we've been doing this for a year or two - looks a lot like the British data. 75 per cent of the time, these things are approved with consensus, with over 90 per cent of shareholders in favour. For votes that actually fail, by getting below 50 per cent - it's a small slice of the pie - about 2-2.5 per cent of the public companies - we essentially have the British system in the USA. If you lose, it's a matter of public humiliation and disgrace, but no contract is changed, no automatic consequences happen. It's food for thought for the board itself, to maybe go back and do a better job the next year.

Case of Citigroup

The one case that really stood out in the USA is at Citigroup. I think everyone knows the background: this is one of the banks, like the Royal Bank of Scotland, that failed in the crisis. The government became the controlling shareholder. They didn't immediately change management; they left the CEO Vikram Pandit in charge of the firm. Basically, two or three years later, shareholders began to complain about Pandit still being the CEO. They voted against the overall compensation package of the company in 2012. [...]

On the day this happened, the stock rose three per cent. For an advisory vote on executive pay, it's hard

to see why it should raise the value of the firm three per cent. This created three billion in value for the stock holders, which greatly exceeds the value of the compensation. [...] The outcome of this, and I think the understanding from the vote, was that Pandit's days were numbered. In fact, within months, he was gone. This was the matter for a lot of celebration on Wall Street, at least for stockholders of this one company, and they focused on this one vote. Basically, "his compensation was a sticking point for shareholders who voted against his 15 million dollar pay package." So they're referring back to this event that had taken place earlier in the year.

This is not a correct statement. When they voted, they in fact voted on a very broad and general question, which is, "Are you happy with compensation at Citigroup?" But the media personalised this. They said, "This is really about one guy." They took this as a personal rebuke.

I think if you didn't want Vikram Pandit to be the CEO anymore, there's a much easier way, which is: vote against him being re-elected to the board. That was also on the ballot that day, and he was re-elected with much higher support. To the shareholders, there were a number of things about compensation at Citigroup that you might have been angry with, beginning with the bonus structure, the compensation of the managers who had left, the overall cost structure of the firm, and so forth. They probably didn't need a new CEO.

But I think this was an interesting case where the message was ambiguous, and for me, it called into question the structure of the whole system. If you're going to have this compensation vote, you'd better be clear on what people are voting about and why. I think that, especially with some of the other laws that have been adopted, they tend to be adopted in an atmosphere of anger and vengeance that undermines the wording and specifics of the law, and so you might get unintended consequences. You might even get CEOs being removed because people think a message was sent that wasn't actually sent.

We can all wish Pandit success in his retirement; he takes a lot of money with him. But whether shareholders truly wished for this? Whether this was the right way to send the message? I don't know, and I'm not sure we'll ever know.

Switzerland

Now let's talk about the Swiss, because this has really been the leading edge of conflict in the last couple of years. It's the heroic efforts of one small citizen who is responsible for what now appears to be a nightmare of regulation that is not only taking effect in Switzerland, but the British, as we'll talk about, are promising to do something even tougher next year, and the whole European Union may sign on to this, if you believe what you read in the papers. This man is named Thomas Minder and he's a small businessperson in Switzerland. His company makes toothpaste, mouthwash and personal care products.

His big client was Swissair. I think as you all know, a number of years ago, in one of the most unlikely bankruptcies you'll ever see, Swissair actually went bust and was liquidated in a particularly messy bankruptcy. The creditors didn't get fully paid. Minder had sold them some toothpaste, which they had given in those little first class travel kits. They owed him money, they defaulted on the debt, and like all the other creditors, he got some settlement. But when the managers walked away with benefits of their own, this outraged him.

So, he decided there should be a law against this. This went through several steps - we don't need to recount the whole thing - it took him about five years to schedule a national referendum. This involved petitions and different layers of approval. Eventually the Swiss had the opportunity to vote on an amendment to the federal constitution about this say-on-pay.

You might think this is a little disproportionate - we have a federal constitution, you probably do too - it's very hard to amend it. You need two-thirds of the USA states, congress needs to approve it, it usually takes 10 or 12 years, and it's reserved for extremely serious things, like allowing slaves to be freed, or women to vote - fundamental changes in political rights.

The Swiss are doing this for executive compensation now. And they're doing it at a level of detail that I think, at the very least, is ill-considered. Minder named this the *Absocker* referendum, which I think translates into "corporate rip-offs." He had a provocative website where you could go read about the issue, and it was really very well-packaged.

A lot of people blame the Vasella contract, which was released just a month before the vote, for pushing this referendum over the line. I don't think this is correct, because this was polling 70 per cent for over a year or two; the Swiss were very much behind this. I'm not sure that Vasella even changed one voter's mind. This, as far as I could tell, was always going to pass.

It's one of those idiosyncrasies of Swiss democracy that they vote on everything. It's reasonably easy for citizens to bubble up organic legislation from the bottom, and if enough people agree, the government has to do it. This is rather different than many countries.

There's a lot in this referendum about governance. The key is point A though: that you're going to have this vote at the annual meeting every year, to vote the total remuneration of the executive board. Now, I don't have this in the original German, but it's not completely clear what this means. But then they go into more detail.

Point B rules out a number of contracts that are extremely common in business. The one that's really going to bite is that you can no longer pay a signing bonus to a manager who leaves one firm and goes to work for another. These things are often very necessary, because if you quit your old firm, you typically leave behind compensation that is partly earned but not yet vested; pension rights. These signing bonuses typically put you in the same position that you were in so you don't have to take a pay-cut or forfeit anything if you change jobs.

Some of these other things - merger bonuses, golden parachutes - are controversial. You may or may not like them. The golden handshake is what Vasella got: the consulting contract in retirement. All I can tell you is that these things serve a certain economic purpose. Even if not popular among the public, it's ironic that shareholders often react positively to things like golden parachutes, because they recognise that they make mergers easier to achieve, and so forth.

Swiss firms no longer have the option to do these things. They're simply illegal. The punishment for giving such a contract to a manager is imprisonment for up to three years, which is very different than the board having to go back and reconsider its behaviour: they now just go to jail. I think this is a big mistake. [...]

One easy prediction is that no managers will ever change companies anymore in Switzerland, certainly not at the top level. This will hugely disrupt the labour market. It puts at risk [...] all the things that the Swiss make.

I've heard two types of pushback from the Swiss - I've got many friends and colleagues in that country - a lot say, 'People don't know what they voted for. They were just angry.' I think that's probably a true statement. 'But if you actually read this, it's a more subtle thing.' The other's that there's a certain belief in Switzerland that the parliament will water this down. When the constitution's amended in Switzerland,

the federal legislature has two years to draft enabling legislation that puts the amendment into practice. The belief is they're going to go into denial – 'even though it says this, they'll still allow these things under a different name.' I think, frankly, a lot is at stake for the Swiss economy. If they're not careful about this, they run the risk of pretty serious consequences. But the legislature has actually tried to intervene already over the past two years, and in each case, Minder would resort to petitions and referendums, and basically got his way. As I read it, their ability to water this down is somewhat limited. They're going to find themselves living under a set of rules that greatly exceeds what any other country has implemented and really has the risk of a lot of negative externalities.

You're putting yourself in a position where you have this relationship between shareholders, the board, and the management that has been the same for about 300 years. Boards of Directors today look a lot like the boards we saw in 18th century England - the first joint stock companies that Adam Smith wrote about very memorably - boards do about the same things and have the same structure. What they're doing is monitoring the managers and solving a collective action problem. Most companies have so many shareholders, and the cost of them meeting is so prohibitive, that you need to delegate this to a group of about twelve people who come to a meeting every month and make a commitment to be informed.

What Minder's referendum does is basically disrupt this dynamic, where the day-to-day work is done here and there's an annual election here. The shareholders can now overrule the board. What can happen in Switzerland, and frankly in various other countries that are adopting similar laws, is that the board reaches a contract with the managers, disclosure, a vote, three or four months are going to pass, and then this contract can be rescinded by vote of the stockholders. I find this just terribly disruptive.

You've got other countries that have done this. I've done some reading on the Netherlands' experience, but I think only about three companies have ever lost the vote in the Netherlands and the consequences in those cases were fairly benign, because there wasn't a lot of agreement on what 'mandatory' meant. [...]

Britain is planning to copy the Swiss referendum, but with a higher threshold - the company doesn't just need 50 per cent, it needs 75 per cent. And if you look at the historical data, something like five to ten per cent of the companies are probably going to lose this vote on an on-going basis, because a protest vote of 25 per cent is not that unusual.

So, the risk is, that this spreads - Switzerland, ultimately, I think is rich enough to solve its own problems. But the UK is a big economy and one that is really influential in a regulatory sense, because what they draft, tends to migrate around the world. In fact, a lot of the USA governing reforms are taken directly from the British. The UK has usually been a couple of steps ahead of us over the last 20 years. Australia and many of the former members of the British Empire, have pretty much enacted these laws more or less as the British write them. I'm just really surprised that David Cameron, leading a pro-business Conservative government, would sign up for this corporate rip-off stuff. [...] Other countries are more or less rushing to sign up to do something similar.

Objections against binding say-on-pay

So, why is this a bad idea? I think there's a set of arguments, some of which I've made before, but these are not the real things that you need to worry about. [… T]hese votes are costly, competitors may benefit from too much disclosure, shareholders can vote on other things already, [...] the board may have better information and better judgement, and ultimately this thing about executive pay being a private matter internal to the firm - all these things are more or less true. But I think they're not really what's relevant

here.

The basic problem with too much shareholder voting is that the consequences need to be spelled out very carefully if you lose, and in this case they haven't, and shareholder voting is a cumbersome instrument in that it takes a great deal of time to organise, schedule and prepare - often three months at a minimum. Contracts are signed much quicker than that. You can't have managers sign contracts, wait three or four months, and then see if the contract is real. Firms need to react much more quickly than that.

Possible solutions

So, what should the remedy be? There are two suggestions that are basically trotted out and talked about as possibilities.

One is that if you lose the vote, you should come back with a different plan, and have another vote a few months later. I think this may be reasonable, but there's no guarantee that you're going to win the next vote either. If people are really angry, who's to say they're not going to be angry in three months? You could end up in an infinite loop where you lose every vote and, as I understand it, the managers simply work for free until they vote 'yes,' and they may starve to death before this is ratified.

A second, more benign solution is that if you lose the vote, you go back to last year's pay scheme. You essentially leave in place the old policy. This may work in a certain number of cases, but there will be other cases where it's just not logically consistent with the facts - if you've hired a new manager, if the firm has merged or has different performance goals, things change, and they often change in ways that the old plan doesn't make sense anymore. In fact, the old plan might have been even worse than the current plan. The current plan may be some effort to scale it back. So I think that just going back to the past and waiting another year has many obvious problems and is probably not a good set of consequences at all.

But one I like is what the Australians have done. They have the 'two strikes' rule. They have this mandatory vote every year. If you lose this vote two years in a row, the board is immediately turned out of office and then has to stand for re-election within - I think it's 90 days. This is good and focuses the attention on who is really to blame.

I wouldn't blame Daniel Vasella for taking the 72 million Swiss francs; I would have done it too. I think everybody would have. The people to blame are the board members of Novartis who thought this was a good idea in the first place. If you're angry, going after Vasella misses the point. You want to go after the board.

The Australians, I think, have a clever solution, because this doesn't disrupt contracts - if a contract is signed it stays active and plans stay in place - but you remove the board itself. This has happened now eleven times. It's just a two-year old law, so this is the first year in which companies came up for the second round - and there are eleven cases in Australia, where the board was forced to resign and then stand for re-election. In all eleven cases they actually returned them to office, so they seem to use this more as a warning than anything else. I think this is much better than putting people in jail, or disrupting contracts, or any of the other things being talked about.

Is this the best solution? Probably not, because it is still rather indirect. If you want to get rid of the board, you can actually vote the board out anyway; you don't need this vote to trigger that. At the very least, it may make the board feel uncomfortable, and I think this is the right way to focus people's

attention.

Consequences of strict regulations

What do we think is going to happen with all this increasingly strict say-on-pay regulation? There are basically three consequences that almost mechanically seem to spill out of this.

One is that managers are not going to switch jobs. Because it's illegal to pay them these bonuses and put them in the same position that they used to be, it will more or less freeze the labour market in Switzerland and any other country that goes for this. You will simply promote people upwards but never hire managers from outside the firm.

A second is that, obviously, some compensation will need to be provisional, in the sense that you sign a contract, you start to pay people a certain bonus, but there is the possibility that they'll have to surrender it or give it back. […] Now, if you tell me your salary is 100,000 euro [for example], but it depends on a vote that will be held four months from now, from people who aren't in the room with us right now, I'm going to demand a risk premium. Any manager who is asked to work under these conditions would view [his or her] pay as somewhat uncertain and so [he or she will] demand a higher base salary. The ironic outcome of all this will be that the managers will end up being paid more. This is exactly the opposite of what Thomas Minder is trying to achieve in Switzerland. But it's just very straightforward contract theory that if you make an outcome uncertain, you have to compensate a risk-averse agent for being willing to stand in that position. If we're going to come back in five or ten years and add things up, people are going to be very frustrated. The constitutional amendment will seem to have back-fired, the Swiss labour market won't resemble what it used to be, the managers will be getting even richer - we'll have to see, but as an academic, this is a fun hypothesis. I'm not so much emotionally involved as looking forward to the train wreck, when we can study what happened and write papers about it. This seems like a wonderful setting, where you can predict negative outcomes, and I'll be around in ten years to write the paper.

Weakness of shareholder voting

I want to make one more point, which is a little bit different. We could have an entire lecture, but I'll just use one slide to say that shareholder voting itself is not the most reliable thing in the world. You're taking a fairly important decision about management compensation, you're saying, 'let's have shareholders vote,' but these votes are very easy to manipulate. What I'm showing you here is a sample of several hundred elections in the USA. The approval threshold is 50 per cent for these votes. [...] You see, very few get 49 per cent, but a lot get exactly 50. There's no reason in the world this shouldn't be a smooth, continuous curve.

What's going on here is that, when things are tight, the managers know in advance, and there's a range of things that can be done, as simple as calling up the shareholders who've already voted 'no' and paying them to change their mind. It's happened very famously with Hewlett-Packard and Deutsche Bank and a merger vote about 8 or 9 years ago. So, if you tell the managers that their pay is contingent upon getting 50 per cent, or 70 per cent, or whatever the threshold is, you can see elections with a distribution like this. It could be the managers themselves, going into the derivatives market, borrowing votes with which you can do this - all kinds of schemes that have been laid bare by academic research. If you need to win a vote in order to be paid, you will find a way to win that vote. It's really not that difficult and I'm deeply suspicious about the reliability of this whole decision mechanism.

Other tools?

What else could you do if you're not happy with these shareholder votes? [...]

Taxation, I think is the favourite thing. If you're unhappy about executive pay, just tax a bit - 80 or 90 per cent - and that very often will solve the problem. Obama briefly tried to limit pay - there was going to be a 500,000 dollar limit on executive pay for all the bailed-out firms. This turned out to be more problematic than he may have anticipated. This kind of direct legislation involves the government and brings political judgement into an equation where almost always the market is deeply at odds with what the politicians wish to implement. Even though the USA has experimented with these things reliably every decade or every other decade, none of these are well-remembered as being good ideas.

You could have litigation. In the USA, from time to time, we've had lawsuits alleging that the managers were paid so much it's unconscionable. Once in a while, these cases come out the way the plaintiffs want. But in the end, having courts decide the pay at every company is probably worse than having shareholder votes.

In the end, it's probably a mistake to get involved in this area at all. Essentially, we call this 'jaw-boning' - where politicians try to argue the case informally and maybe even target individual companies to make examples of them - but indirect, policy-based regulation is probably the best approach here. Delegating these things to the managers and boards involved is probably more efficient than any other system that has been discovered. Maybe there is a better way, but I don't think it's these say-on-pay votes. They strike me as deeply inefficient and full of side-effects that are going to have significant, unintended consequences.

Let me make a few brief closing points, and I want to mention that the Swiss, having passed this one referendum, are coming back next year with something even better, which they call the one-to-twelve proposal. [This] is again a federal amendment to the constitution, [stating] that the highest salary paid by the company cannot exceed twelve times the lowest salary. I'm not sure who the lowest-paid person here is at Erasmus, [...] but think of what they make, multiply it by twelve, and that is what the professors and the deans [...] would make. Maybe this is a good idea - it's a pretty aggressive form of social engineering. It's not so much an attempt to limit the top, as to raise the bottom. This is coupled with an idea that the minimum wage should be now 4000 Swiss francs a month, which is really a lot of money for a minimum wage. Will this pass in Switzerland? It's polling in favour - last time I checked: 50 per cent. Who knows? This is obviously far more dangerous to the labour market than the corporate rip-offs. If you're a labour economist, it is going to be fun if they enact this: to see people migrating from Switzerland. I think a lot of poor, unskilled people will move to Switzerland so they can make 4000 Swiss francs a month. I wish them a lot of success with this.

The European Union is capitalising on anger about bankers' bonuses. The problem - if it is a problem - is shown by this new story about Merrill Lynch. Merrill Lynch, as you know, had basically failed during the crisis - there was a forced merger with Bank of America - and the government stepped in to cover the payroll of these firms. It turned out that a lot of these guys at Merrill Lynch were paid more than ten million a year; there were 149 people who got at least three million. This was government money and people were furious. And so, limiting bankers' bonuses has become a political imperative everywhere in the world.

The EU has, rather ingenuously said that, starting next year, no banker's bonus can exceed two times the base salary for that person. Now, what's going to happen as the consequence of this? This is as clear as

the sun rising! Base salaries will go up. If ever a law is destined to backfire, it would be this one. This is elegant in how simple it is and just purely idiotic. It's going to raise bankers' pay across Europe - which is the opposite of what they're intending - and I think the more serious point is, that the flexibility of the banks' cost structure will be totally gone. In the old days, if the bank had a bad year, nobody would get a bonus and the cost structure would drop. Now the cost structure can be fixed and if the bank has a bad year, you've still got all these giant salaries to pay. So, will more banks fail, or less? You can answer that for yourself. I have no idea who came up with this in Brussels. I think any economist who looks at this will see immediately: this is about the worst regulation scheme you could ever implement.

Case of Pacific Brands

I think, in the end this is a very subtle area, where people tend to reach knee-jerk judgements that greatly oversimplify the social issues that are at stake. This is an example from Australia, which I used in a lecture before, and I think, even though it's not European, it reflects the underlying issues extremely well.

This is a company called Pacific Brands. It makes underwear and they're the leading manufacturer in Australia. The CEO moved jobs offshore; she sacked 1,850 employees and outsourced the jobs to Thailand or a country like that. They said that this was very cynical - that she moved jobs offshore to increase profits, as though this were shocking - that a firm would try to increase its profits.

The politicians jumped on this. The labour party said that this was "frankly sickening" - that she got a bonus when people were fired. The other side, the conservatives, were "Horrified - They're going to take a hit in terms of their public image. “

This was framed as a very simple set of gains and losses where 1,850 people lost their jobs, tax payers get dragged into it to pay the welfare costs, and the CEO, grinning, walks away with the bonus for being creative enough to make money.

But this greatly shortens the list of people who benefit. By outsourcing these jobs, the shareholders got a greater rate of return, and people's retirement savings went up in value, the bond holders are more likely to be paid back, the customers get cheaper underwear, jobs are created in Thailand - so there's 1,800 people who benefit there - and the taxpayers will collect more income tax [...]. I think without a fair accounting for all the gains and losses, to oversimplify this and just go for the manager's bonus, runs the risk of cutting off all these other social gains, which ultimately represent progress and economic growth.

Market forces

In a capitalist economy, the return on capital is actually pretty important. Market forces are probably the best way to solve these problems and allocate resources in a competitive economy. If you just sack every manager who gets a bonus that the public thinks is too big, you'll end up sacking some of the most productive ones and you'll also end up compromising other important social goals, like inexpensive products, high retirement savings, and safe bonds - these are all things that we want, but we seem to want them without the managers being rewarded for delivering them to the market.

So, I think it's a very interesting time, where shareholders and especially the general public have gotten extremely aggressive about regulating this issue. The leading front of this regulation is right here in Europe - so it's a good place to be researching and studying this - but I think the political decisions being taken are doomed to be very counterproductive, if not outright destructive, to the economic growth. There are a lot of economies in Europe that are struggling right now, and I think in many places the problem is not that incentives are too high, but that, frankly, it's the other way around: that they're way

too low. What's being done here is really a step in the wrong direction.

[...]

Thank you all for your kind attention.'

Questions from the audience

Question: I think the real reason that people are angry and want to regulate executive compensation is perhaps a fifth point: they think it's a form of self-dealing. When in 2004 the binding say-on-pay for the Netherlands came, the reason was that they thought it was some sort of 'old boys' network" wherein everybody was giving to each other, so the trust in the board was gone.

Professor Yermack: 'I guess I have two responses. This is not a new theory. It's a hypothesis that researchers have looked at and you can expand it to include people like compensation consultants who are paid fees, and so forth. The academic research on this point is dreadfully short of results. A lot of people are lured into this area thinking "I'm going to show that this guy knew that guy, and pay went up." If you actually study this with data, there's very little evidence that it's actually true. It's a case where a number of anecdotes have succeeded in capturing people's imagination, but the broader market practices are not characterised by this. There's an enormous amount of independence, transparency, and accountability built into the system. And, more to the point, if you really think the board is corrupt, you can vote the board out. You don't need to interfere in each decision the board makes. There's already a remedy, that I think is much more constructive: any director with a conflict of interest should not be re-elected to the board. You've had that right as a shareholder since the beginning of time. I myself have written some of these unsuccessful papers and I regretted spending my valuable time on this. There's just not so much evidence that this is really the case, I'm afraid.'

Question: Do you actually believe that social inequality doesn't have any negative effect on the economy?

Professor Yermack: 'No, I think social inequality is important in that you need something for people to aspire to. We've seen societies that have tried to make everything equal, and they've been spectacularly unsuccessful. Any economist thinks that incentives matter. For that to be true, you have to have rewards for people who are the most productive. So, should it be twelve to one, 50 to one? Are there limits that are intolerable - that no one could ever conceivably earn such a salary? I'm not sure which economic theory would point us to what that number would be. This, I think, is more of an American value than a European one, but we believe in inequality, because it serves a very useful role in the society - of rewarding productive people and giving young people something to aspire to.

Question: There isn't any research on the optimal level of social inequality?

Professor Yermack: 'No there really isn't. There are ways of measuring it - things like Gini coefficients and the distribution of income, but these are strictly positive and not normative statistics. You can say, "the top one per cent of the people have 40 per cent of the wealth" in whatever country you want to pick to illustrate this. But in terms of what's optimal, I think the one thing we can say is that, when everyone's equal, it destroys the economy. The Soviets proved this abundantly over the 75 years they've tried to implement that. Everyone is equally poor, is the outcome of that. But no, I'm not aware of any academic research with academic rigour behind it that would identify the optimal distribution of wealth. I think for these young people in Switzerland, to think it's twelve to one at the limit, is interesting, but I wonder exactly how they came up with that. Why not thirteen to one, eleven to one? Where are they getting their numbers - I've no idea.'

Question: Is the conclusion of your lecture that there isn't any problem in executive enumeration?

Professor Yermack: 'I think by and large, the system really works pretty well. The cases that you tend to hear about are anecdotal, and they represent maybe five to 10 per cent of the firms messing up. Most of the outlier contracts are mistakes, written by boards that weren't paying attention. Definitely, things should be done, but I think the tools to address those cases which are reasonably infrequent have existed for a long time: you can call these people up and meet with them; you can vote them out of office. Usually companies that do a very bad job at executive pay get themselves into trouble for other reasons and become take-over targets. But I think it's surprising how broadly executive pay is ratified. When given the opportunity to vote, three-quarters of the time more than 90 per cent of the people vote that it's OK. For the very large majority of companies, executive pay really works pretty well: there are strong incentives with the rewards for the managers strongly tied to their performance; the contracts are transparent; conflicts of interest are really quite small. What's happened in this area is: a relatively small number of cases have been telescoped into a dangerous national trend that belies the facts on the ground.'

Question: I didn't hear you mention the risk-taking and the short-termism for bonuses. You did mention that there is now a limit of two times the base salary for the bonus. In my opinion, there is a bit less incentive for quick wins and short-term gains for bankers; to not have an excessive bonus of four, five times your salary, which is paid within a year, but one which is paid over multiple years.

Professor Yermack: 'These are two distinct issues, and I think I did address the risk-taking with respect to the convexity of compensation. There's a school of thought that bankers had motivation to take too much risk. The short-termism for me is tough, because in finance, we don't recognise a distinction between short-term and long-term performance. We refer to the stock price, and the stock price is supposed to internalise the whole future value of the company - all cash flows from now 'till the end of time. So, there really is no such thing as "short-termism." You're always trying to maximise long term-value, as that's the only thing that the market rewards. The folklore in bonuses is that you can take extremely large gambles for a year, knowing that if it doesn't work out this year, you can re-enter the tournament with a clean slate next year, and so the equilibrium is: you just take a huge amount of risk in a short-term gamble, and if this works out one year in three, you're going to be really rich. I think this may have an interesting aspect to do with the crisis - that if you could get inside these banks and look at how traders and managers were rewarded, there may have been contracts with bad performance measurement and very short measurement periods. We just don't know, because this data is almost impossible to get for research purposes. I think, though, what a lot of people miss in this dynamic, is that if you take huge risks and fail, often you actually get fired. You don't get to enter the mix again. Your continued participation is contingent on actually earning the bonus fairly regularly - meaning that your risks pay off. So, these hypotheses have a lot of popular appeal, but I'm really unaware of research that supports them, despite the fact that a lot of people are looking. I think partly this is a disclosure problem: we don't learn so much about mid-level compensation. But many of the studies done on banking CEOs and so forth, they find pretty much the opposite story: that the CEOs with the strong incentives actually didn't go bust. I think that you really need to make reference to data if you're going to make these arguments, and almost nobody is able to do this, one way or the other. This is unfortunate, but that's what it is.'

Question: I agree with you, that there's not that much equitable data, but there are some books written by former bankers, like Michael Lewis, and also bankers who have resigned and have then written letters which were made public.

Professor Yermack: 'If this is good enough to support a vote in favour of legislation - Michael Lewis writes *The Big Short* and then congress says, "Yeah, Michael Lewis is right" - but this is not what we think of as research. These are anecdotes, and what you often do with an anecdote is pick the outlier at the end of the distribution and write a book just about this one case where things went horribly bad. If you mistake this for a representative case in the middle of the distribution, you may do something very counterproductive.'

Question: You were talking about public anger and envy. So, for you, where's the real root of the problem of this anger that is also expressed in mistrust and people believing in conspiracies? Is there something wrong with the social welfare system?

Professor Yermack: 'My answer, which really hasn't changed much over time, is that the lack of opportunity for young people - the high youth unemployment and the hopelessness that that creates - is really the biggest social problem. If you ask me what people are angry about, it is the fact that high unemployment, a lot of risk to social welfare systems, and slow economic growth seem to reinforce themselves in a rather vicious cycle. There's a society in Western Europe where entrepreneurship is punished by taxation and regulation. That if you get really rich, they try to take the gains away; give them to people who are not working. I think this leads to a lack of job creation. This is not so much a problem in the Netherlands, as it is in France, Spain, and other countries that you're aware of, but I think that when you have social anger and political pushback, it's often born out of the failure of the economy to deliver jobs and opportunities for the fairly significant majority of the citizens, especially the younger citizens who tend to be more politically active. You have two schools of thought about how to fix this: either more incentives or more redistribution - it's very hard for these two things to co-exist. I think over time, there's been way too much redistribution, and pretty methodical stripping out of all the incentives and rewards for people who are successful. So you get people like Gerard Depardieu moving to Moscow, and various other outcomes, where all the talented people look for greener pastures, and you're left with a society that can't sustain itself. This is a long-term problem that the crisis has tended to accelerate, but it's not anything new - people that looked at Europe have seen this coming for 30 or 40 years. I think the crisis has made it a more urgent problem. These fixes of confiscating the bonuses of bankers and outlawing signing bonuses for manager: they're going to do nothing to create jobs. They're just going to make the problem much worse. Sooner or later, something is going to have to give way, and I hope it's a soft landing, but I'm very concerned about how this may play out.'

Panel discussion

In a panel discussion moderated by Sandra Phlippen, editor-in-chief of the leading Dutch economy journal *Economic Statistic Messages* (*Economische Statistische Berichten*), Professor Yermack and three other experts discussed their views on executive compensation and answered questions from the audience.

Zacharias Sautner, Associate Professor of Finance at the University of Amsterdam, argued that contrary to the American shareholder-focused corporate governance view that Professor Yermack represents, European laws stress the long-term stability of the firm. In the German system, employees are also seen as important stakeholders who can nominate half of the members on the Supervisory Board. That has implications for compensation. We often forget the externalities, the German associate professor argued: 'There is increasing research on behavioural economics, showing that if you want to motivate people – your employees – what matters a lot is that they have a feeling of fairness.' If managers get a high compensation, employees may be demotivated because they feel disadvantaged. He also raised a second aspect more specific to banking: many talented students are drawn to the banking sector – an intermediation sector that doesn't create value – because of the financial compensation.

Mr Rients Abma, Executive Director of the Eumedion, the Dutch Corporate Governance and Sustainability Platform for Institutional Investors that represents around 20 per cent of all Dutch listed shares, shared his insights into Dutch executive enumeration policies. '[I]n the Netherlands we introduced a binding say-on-pay already in 2004. It is a binding shareholder vote on remuneration *policy*.' Specific remuneration elements are up to the supervisory board. As in the UK, this binding say-on-pay vote has already generated more dialogue between shareholders and remuneration committees months before the final proposal is submitted to the general meeting of shareholders. The effectiveness of remuneration policy is reviewed by the supervisory board every three to four years, and a new policy proposed to the shareholders, taking the input of individual shareholders and shareholder organisations into account. In the month before the general shareholder meeting, shareholders, shareholder advisors and proxy advisors have the opportunity to study the new proposals before the vote. Advisors advise their clients prior to the vote. Since 2004, only three or four proposals have been voted down in the Netherlands, and only four proposals were cancelled due to strong shareholder protests before the general meeting. 'It's more or less the *polder model*, in which shareholders and employees are consulted on the final proposals that the Board of Directors are submitting to the shareholders meeting. Because of this consultation process, we don't have many rejections.'

To Frank Hartmann, Professor of Management Accounting and Management Control at RSM, overviewing the supervising choices of people who have leading positions in organisations is a more generic problem. 'We would like to see these supervisors act as parliament members in a democracy. We see especially international firms taking over the roles of classical national authorities, and I think, from a sociological perspective, that would also allow us the predict the roles of these people in supervision – they would look much more like people voted into power to control the local authorities. Within the classical economic paradigm, there's not much room for these kinds of considerations – you'd probably have to move towards political economy to combine the two views.' Economics is useful for explaining the status quo, but not for predicting the sort of changes brought about by public outrage and envy, he said.

Professor Yermack agreed that consensus and negotiation are important. The more influential institutional investors involve themselves with the board, the better the outcomes. 'I think this is terrific,' the professor said. He also agreed with Dr Sautner, that the European system focuses more on a

constituency view of governance, but it's a bad idea, in his view. 'The basic problem with stakeholder capitalism is there's really no way to tell if it's meeting the needs of the other party. You're in favour of outcomes that are more "fair". What is fair? Is it making Daniel Vasella poor? Maybe that's nice, but that's really not about promoting the interests of other people so much as tearing down one CEO who had a windfall. I think, most obviously, the European system is supposed to be predisposed to help labour. But what we can all see with our plain eyes is that the labour market in Europe is an utter disaster. The irony is that, classically, the shareholder-centric capitalism has had much better outcomes for labour than the labour-friendly system. This is a tough thing for European economists to try to justify, and even harder for politicians.'

Dr Sautner responded that systems are constantly changing and many people are quite happy with the European system. 'Once we make the real comparison of the costs and benefits from a labour perspective – when you think about the free education you get here, the free healthcare, and so on – then an analysis that just looks at what fraction of the total welfare paid out of corporations goes to labour and to capital looks a bit different, but I'd like to go back to the earlier discussion of say-on-pay.' On two points, Dr Sautner challenged Professor Yermack's view. First, say-on-pay appears to be beneficial. Papers by researchers at LSE and INSEAD demonstrate that whether a vote gets 49 per cent or 51 per cent is random, but even when the outcome is negative, the stock prices react favourably. Second, looking at the studies of announcement returns – how the stock market reacts when parliament states it will introduce say on pay – stock markets also tend to react favourably for firms where it is believed that there is excess compensation. A final, important argument for Dr Sautner to be in favour of say-on-pay with binding, harsh consequences is that say-on-pay is a credible threat. Companies will want to structure pay in ways that will avoid negative outcomes – 'that's the explanation why we see so few negative votes.' Finally, he added, 'In a lot of systems, you as a shareholder actually have very little influence on the Board of Directors.' Shareholders can't generally nominate members for the supervisory board.

'The argument is very similar to the one for encouraging nuclear weapons,' was the response of Professor Yermack. 'Essentially, if North Korea and Japan have these weapons, the world will be safer, because we will be much more careful about not getting them angry. Fair enough – it's a very right wing, Reaganesque argument, but if you want to go in that direction, you'll be very much at home in my country. But the research you mention – […] I was involved in helping it referee and give advice on both of these papers – they both deal with the non-binding, "soft" American system. The point I'm trying to make is that the good idea, which I think is reflected in these papers, has been hijacked and […] they have twisted this thing in a way that's going to have many negative side-effects.' The UK and Dutch systems are working well, but they're a bit vague on what is voted about, and non-binding.

In some cases, there are material amendments to the remuneration policies of companies, Mr Abma said. The system that is now being introduced in the UK is exactly the same as in the Netherlands. They're proposing to have a binding vote on the remuneration policy, and at least 70 per cent of the votes cast should be in favour. To his knowledge, they will not import the Swiss system with micro-management by the shareholders; determining executive pay should be done by the Board of Directors. In the case of Switzerland, the prohibition of sign-on bonuses will be detrimental. Finally, Mr Abma declared himself to be a proponent of binding votes on remuneration policies, as shareholders are entitled to monitor the supervisory board. The EU will make binding votes mandatory, which will provide effective checks and balances: the Supervisory Board oversees management and the shareholders monitor. There are too many conflicts of interest in having the Management Board involved in setting its own remuneration, he said. 'I think this would work in all economies – all countries.'

In response, Professor Yermack again warned against the time lag between the board reaching a contract and the binding shareholder vote a few months later. 'If you're really going to do this, the consequences shouldn't impact the manager, they should impact the board.'

If a new manager is remunerated in shares, in Europe, the board needs shareholder approval for giving out new shares, argued Mr Abma, while in the USA, it doesn't if the shares fit into an inventory of new shares that has previously been agreed upon, according to Professor Yermack. But in practice we don't experience any problems with this system in Europe, Mr Abma added.

Professor Hartmann proposed to get back to the real issue. He agreed with Professor Yermack that the cases that inspire public outcries are only anecdotes that are unsuitable as a basis for drafting new laws, but he added that the American professor's CEO without pay was no more than an anecdote either. He noted that, in research, higher pay dispersion hasn't been associated with lower firm performance. Unlike Professor Yermack, Professor Hartman did not want to label people's feelings in negative way, using words such as 'envy.' The Dutch professor: 'My question would be: how can we use sound economic theory – and other theories – to inform policies that cater to the needs of people who utter frustrations?'

Professor Yermack responded that he has no idea how to measure fairness – it's 'untestable' and 'unverifiable.' He explained that the papers on pay dispersion he is aware of are badly researched. He has sympathy for issues of morale within the firm, but he would like to see validation. Ironically, in Europe, where people are angriest, disclosure is worst, he argued. In Europe, there is a great concern for the privacy of the managers, so that executive pay is opaque even to the shareholders. The opaque European disclosure system facilitates payment in kind and tax evasion. 'There should be a lot more transparency, and for researchers that would be a bonanza,' he said.

Dr Sautner pointed out that the structure of Philips' compensation plan is high on the agenda of the firm's next annual shareholder meeting, demonstrating that say-on-pay drives companies to engage into dialogue. Coming back to the issue of the board of directors, he added that the American situation is not ideal yet. The Council of Institutional Investors (CII) has requested a better definition of independence for members on the compensation committee. The CII has also asked for a study on why say-on-pay votes had negative outcomes. In more than 90 per cent of the cases, it was because investors said there was insufficient pay for performance. 'How can we make sure than compensation is properly set?' If the structure's right, you can question it from an ethical perspective, but not from an economic one.

Questions from the audience

Responding to a question from the audience – whether the banking sector is an exception when it comes to regulating compensation – Professor Yermack said it's tough for economists to understand banking. If we don't want them to take too much risk, then why are banks owned by shareholders, who expect a relationship between risk and return? They will diversify risks. 'There is a simple solution to bank compensation, which is: you don't pay them in equity, you pay them in debt. […] If the bank fails, they get the same deal as the depositors and the creditors.' But if people want to avoid risk, banks should be nationalised and run like utilities.

A member of the audience noted that peer group comparisons are driving up pay. Dr Sautner responded that this is indeed an issue. 'We need a discussion about two types of advisors: one is the compensation consultants, and the second is the proxy voting advisors.' There are but few compensation consultants, who not only want to influence what the CEOs pay checks look like, but also other issues like pensions. The CII has asked for more transparency not just on pay, but also on other contracts. The proxy voting

advisors move 30 to 40 per cent of votes and give advice on corporate governance. They use simple models to base their recommendations on.

Mr Abma added that in Dutch corporate governance code, the remuneration expert hired by the supervisory board should be independent of the remuneration consultant of the management board. He acknowledged that fixing pay on the basis of comparisons with peers is a big issue. The remuneration committee should be more critical of which companies should be in the peer group. In the case of bankers, their compensation should be below the peer group. On the topic of proxy firms, Mr Abma said there were but a few in the Benelux, but 'of course, it's not rocket science.' It should be easy to understand. And the proxy firms are working on a code of conduct.

In response to a question by Ms Phlippen, Mr Abma declared that he considers qualification as a key criterion for members of the board of directors. Not only should they be experts, but they should also have diverse backgrounds. In his view, the European discussion is focusing too much on the representation of women, instead of recruiting people with different social backgrounds and fields of expertise.

Research on diversity is limited to the gender issue, Professor Yermack added. A number of countries are enforcing quotas. '[T]o the extent that we have data on this, it has been disastrous for the value of these companies.' The more female directors the companies have had to add, the more stock prices dropped. 'This is a very uncomfortable result,' the American professor said. 'When you enforce diversity as a value, and make it a goal of the firm, you seem to be compromising other important goals, such as the return on capital.' Everyone on the board should be a financial expert and adding people from different social backgrounds is a bad idea, according to Professor Yermack. 'If you use boards as a tool of social engineering, research suggests that you're making a big mistake.'

Dr Sautner said that Dutch organisations such as housing associations are characterised by openness: anyone can apply to become a board member.

Professor Hartmann's criterion for adding someone to the board would be, 'Do you add something to the discussion?'. Financial expertise should be a big part of that, but the ability to pick up signals in society for necessary changes is another, he argued. He is in favour of adding people with a broader background, albeit they should be educated to work in these processes.

A member of the audience asked if it would be a good idea to have diversity on the board in terms of economic interests. Dr Sautner replied that, according to the standard arguments, all other constituencies are protected by contract. Having said that, placing employees on the supervisory board in Germany has had minor, positive effects. But having employees on the board will not necessarily lead to them asking critical questions, as they can be bribed. 'But what about the representation of credit?' a member of the audience asked. We *do* need to think outside the box in the banking sector, Dr Sautner responded. Mr Abma added that the complete board of directors should monitor the financial structure of a company. So he would not be in favour of having the different stakeholders directly represented in the board, as they may have direct interests.

From the audience, Dr Dan Zhang suggested non-monetary incentives might replace excess pay.

Non-monetary incentives are indeed important, Professor Hartmann responded. They are ultimately more important than money. The ultimate measure of performance may be happiness. He also pointed out that in our labour market, visibility and stardom are adding to status, and therefore to monetary value. He believes that there is an inherent tension in expressing someone's value in monetary terms, although disentangling all issues involved will be difficult.

Dr Sautner mentioned that the army already functions with honorary distinctions, and that there is increasing evidence that prestige and status matter in firms as well. People are willing to accept a lower pay if the firm is a big brand. In addition, we shouldn't forget that too much focus on money can crowd out intrinsic motivation, he warned.

Professor Hartman added that the monetary value has become a factor in the prestige. 'Money adds to prestige.'

Closing the panel discussion, Ms Phlippen asked Professor Yermack if his views had changed during the course of the discussion, in the direction of say-on-pay. He replied that he isn't against it, but against the hijacked version. 'At the end of the discussion, my views haven't changed about anything.' He found it good to hear that the EU is leaning more towards the Dutch than the Swiss system. 'You have to give people room to negotiate, and not have direct consequences that will destabilise these firms. That's my real concern.'

Transcription Maaike Siegerist