THE CHANGING ANATOMY OF CORPORATE CONTROL AND THE MARKET FOR EXECUTIVES IN THE UK

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Abstract

This paper examines changes in the pattern of CEO and Executive Directors pay and the extent of non-executives and financial institution involvement in the governance structure of giant UK companies over the period 1980-1996. It reveals that corporate boards remain dominated by 'insider' directors who have spent most of their careers with the same firm. This is especially true at CEO level. There are signs of a more active inter-company market in junior executives but the most striking change in the sample is the widening of the pay gap between CEOs and other directors. The current agenda for reform of the board structure of UK quoted companies has done little to address the wider issues of community responsibility raised by Berle and Means over half a century ago.

Key Words: Corporate Governance, CEO Pay, Non-Executive directors, Financial Institutions

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Introduction

In the course of the last decade the relationship, or lack of it, between chief executive officer (CEO) pay and company performance in the UK has led to a fierce debate over the legitimacy of the process whereby CEO pay is set and the means by which performance is monitored. There have been heavily publicised pay increases for CEOs of large UK firms, in particular in newly privatised utilities, combined with major litigation over alleged fraudulent behaviour by CEOs of some of the country's largest businesses. This has produced growing concern over the ability of corporate governance structures to monitor CEO behaviour, and design remuneration packages in the interests of the corporation and its stakeholders, whether the latter are narrowly defined, as is usually the case, as its shareholders, or more broadly defined to encompass providers of debt, or the workforce. This has led to a move towards self regulation and reform. The influential Cadbury Report (Cadbury 1992) set out a code of practice aimed at strengthening the unitary board structure of the UK. A statement by companies of the extent of their compliance with the Cadbury Code of Practice was adopted by the London Stock Exchange as a continuing listing requirement. The Cadbury Code was aimed partly at separating the role of Chairman and CEO and partly at strengthening the independence of non-executives so as to provide checks on any individual's 'unfettered powers of decision'(p. 58). Non-executives, it argued, should be appointed for fixed terms after a formal process involving the Board a whole and should be 'independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholding'(pp. 58-59). Institutional shareholders were encouraged to take a positive interest in the composition of boards and the appointment of high quality non-executives to them (p. 54). Boards it recommended,

should be guided in pay setting by a remuneration committee consisting wholly or mainly of non-executives, and have an audit committee with at least three non-executives to help maintain an objective and professional relationship with auditors. It also recommended that directors' service contracts should be no longer than three years with renewal subject to shareholder approval (p. 59). As far as executive pay was concerned the Code recommended full and clear disclosure of directors' total emoluments, and those of the CEO and chairman, with a clear separation between salary and performance related elements, and a clear indication of how performance was to be measured. The subsequent Greenbury Report (Greenbury 1995) focused solely on remuneration. It recommended that a statement of compliance with its code of practice should also become a listing requirement. The report sought to strengthen further the role of remuneration committees by recommending that they should consist solely of non-executives. The remuneration committee chairman should be present at AGMs to explain remuneration policy, and should provide a report on it each year to the shareholders on behalf of the Board. Much fuller disclosure of the details of service contracts and remuneration packages were recommended with especial emphasis on share option and other long term incentive schemes and pension arrangements.

In spelling out the factors to be taken into account in setting pay the Greenbury Study Group noted that the advice they had received suggested that UK CEOs and directors were paid "within the range of European practice" (§6.9). Market forces, they argued, especially in 'international industries and certain skills', set a broad framework within which pay could be determined. They also noted however that there was an "imperfect market" for executive talent. They observed that many directors spent all or most of their working lives within the same organisation with pay determined by internal committees rather than directly by market forces. Thus there was 'quite a wide range of discretion' for internal pay setting to operate (albeit subject to market related lower limits for senior executives of the largest companies

(§6.2-6.4)). The disclosure and reporting requirements of the Cadbury and Greenbury reports have not dampened the debate, although the Cadbury report has certainly raised its tone. A third report as a successor to Cadbury and chaired by Sir Ronald Hampel is in preparation.

Central to both of the Cadbury and Greenbury reports is the notion that there *is* a market for executives, and that in the process of pay setting due regard must be paid to salaries available elsewhere, especially in the context of an international market for top talent. For CEOs and senior executives this market is recognised as imperfect. Senior executives are typically insiders, and hence 'outsiders' (i.e. non-executives) should be used to take an objective view of outside comparators and performance estimation. Financial institutions, as dominant and potentially powerful shareholders, should play a lead role in ensuring that board composition and selection facilitate this. Governance structures are therefore central to proper pay setting and ultimately to the legitimacy of the corporate system. That such legitimacy matters was a central theme in the seminal work of Berle and Means who stressed the link between corporate behaviour, the recognition of wider community interests in corporate decision making, and the acceptability and survival of the corporate system as a whole.

It is conceivable - indeed it seems almost essential if the corporate system is to survive - that the 'control' of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity (Berle and Means 1932, p. 356).

The issue of the private cupidity of executives and its link to corporate behaviour have, of course, a long history in the academic discourse over the separation of ownership from control which followed from the work of Berle and Means. The functioning of the market for

executives and the incentives embedded in their pay structures lies for instance at the heart of Marris's model of the growth of the firm in 'managerial' capitalism (Marris 1966). He argued that dispersed shareholding meant weak control over managers, and that insider career structures combined with a desire for status, prestige and a high salary (linked to size and not profits) meant the pursuit of corporate growth in the interests of inside management at the expense of shareholder welfare. A thin market for executives with little transfer between firms was central to this argument. An active market which permitted career switches to larger firms for higher pay would be as effective in raising pay as increasing the size of the insiders own corporation. Moreover in an active market shareholder concerns could come more forcefully into play in the hiring and transfer of executives between firms. Marris contrasts his view of the market for executives with what he regarded as a neo-classical view in which a shareholder committee designed executive incentive structures:

> "Down on earth there are no shareholders' committees, at least in our sense. Managers determine one anothers salaries and are far from elastic in supply. They represent a non-competing group in relation to the rest of the population and are typically paid considerably more than would be necessary to discourage them from turning to alternative occupations. They are not good substitutes for one another, and when combined in teams are normally much more 'productive' in the firm where the team was developed than in any other firm of comparable size and character (if this were not the case we should expect to observe considerably more statistical mobility among corporate officers) (Marris op. cit. p. 89)

Moreover he asserts that " whenever and wherever a vacancy occurs, the *probability* of its being filled by internal promotion increases with the *level* at which it occurs." (Marris op. cit. p. 103 original italics)

Despite considerable evidence on senior executive long service as insiders, with average in- firm careers spanning 20-25 years (Kostiuk 1989, Murphy 1985, Cosh and Hughes, 1987), and theoretical arguments based on team-centred and asset-specific human capital, it has nonetheless been argued that the possibility of a credible threat of CEO transfer can provide a suitable incentive system to align their behaviour with the interests of stockholders (e.g. Fama 1980, Main et. al. 1996). It has also been argued that there is a credible threat of executive dismissal for sub-optimal performance either directly, or indirectly through takeover (Jensen and Ruback 1983, Gilson 1985, Martin and McConnell 1991, Rosen 1992, Weisbach 1988). Moreover the growth in the significance of financial institutions as shareholders, noted over three decades ago by Berle (Berle 1960), has placed them in a potentially powerful position to enforce such sanctions on poor performance thus offsetting the argument that dispersed shareholdings have weakened the potential for shareholder "control".

Whether these threats and sanctions do provide the incentive structures desired is of course a moot point. There is a large literature examining the links between corporate performance, executive pay and dismissal, and takeovers, though relatively little examining the specific role of institutional investors within it. What evidence there is for the UK suggests that, despite their domination of shareholdings they have had a limited impact so far (see for example Cosh, Hughes, Lee and Singh 1989, Cosh and Hughes 1997, and Cosh, Hughes, Lee and Singh 1997, and for a general survey of the links between ownership and performance Short 1994). Our purpose in this paper is not a further direct examination of these links. Instead we wish to examine the current structure of boards and the anatomy of corporate control in giant companies in the UK to see if the stylised facts which underlie the managerialist insider interpretations of governance and pay setting structures still hold true. In particular we wish to update an earlier analysis of these features at the turn of the 1980s (Cosh and Hughes 1987). This will enable us to gauge the extent to which there have been changes in the last decade and a half consequent upon the

further extension of the share of financial institutions' ownership of UK equities, the implementation of the Cadbury Code of Practice and the exhortation to strengthen the status and role of non-executives. This will enable us to examine the extent to which it remains true that senior executives are primarily drawn from inside the organisation, and the extent to which it makes sense to regard non-executives as independent outsiders. Finally, by measuring executive turnover and CEO replacement in the past decade compared to earlier periods, we can comment upon the extent to which the rhetoric of an international market for executive talent, and an enhanced degree of uncertainty of executive tenure in an active market for executives, are reflected in the facts.

The Sample and its Significance

Our sample consists of 27 companies ranked between 1 and 55 in *The Times 1000 1981-81* and a further 8 companies drawn from the top 100 of *The Times 1000 1996.* The sample for 1980/1 was analysed in detail in an earlier paper (Cosh and Hughes 1987). Of the 27 firms in that sample 5 were no longer independent in 1996 and we therefore have 22 firms with which can make direct comparisons over time. We enhanced the sample for 1996 by 8 firms to allow us to maintain a similar industrial balance to our earlier study and to include some newly privatised utilities which have been at the centre of much of the recent controversy in this area.

Table 1 shows some basic characteristics of these samples. Our 1996 sample employed 1.8 million people with total sales of almost £200 billion. Together they represented around 45% of the sales and employment of the UK's top 100 companies and 35% of their assets. These are large corporations by any standard and it is amongst corporation such as these, if anywhere in the UK, that we should perceive the workings of a market which reflects international standards of remuneration. The sample for 1995/6 is broadly comparable in absolute size with our original sample for 1980/1 but

with somewhat lower sales (adjusted for inflation) and employment. It is less important as a share of the top 100 in the relevant year than was the sample for 1980/1, but this partly reflects the addition of the newly privatised utilities, banks and building societies to this group. The lower half of table 1, which compares the constant sample of 22 firms in 1980/1 and 1995/6, shows that this is largely a reflection of the relative downsizing of these survivors, with employment in particular falling in this group from 1.7 to 1.2 millions.

Table 2 reports median percentage changes in a range of growth, performance and executive pay variables (all in real terms) for our common sample over the decade and a half covered by our analysis. The decline in real sales, assets, total employees remuneration and employment is in contrast to the substantial rise in market value which shows that this group of companies moved in line with the market as a whole (the deflated change in the FT Ordinary Share Index from September 1980 to September 1995 was 243.4%). This table also reveals the substantial increase in CEO pay over this period, both in absolute terms and relative to that of other directors and of the average employee. CEO remuneration measured as basic salary plus bonuses and the cash value of perks, but exclusive of stock related elements and pension contributions, doubled in real terms over the past 15 years whilst for the board of directors and the average employee the rise was around 65%. The massively increased use of stock options since the mid 1980s means that this increase substantially understates the true growth in CEO pay. In the early 1980s CEO pay inclusive and exclusive of stock options were little different. By the late 1980s the value of stock options accounted for around a third of total CEO remuneration, and incentive related stock holding by CEOs dominated their other shareholdings (Main et. al. 1996, Cosh and Hughes 1997). We return to this issue below when we examine the remuneration packages of our CEOs in more detail.

Board Composition and the Characteristics of Executive and Non-Executive Directors

A first step in examining board structure is to look at overall board size and the split between executive and non-executives. This is shown in Table 3 for our samples of firms for both 1980/81 and 1995/96. A comparison of the full samples in each year shows a slight decline in median board size, and a significant fall in the median proportion of executives from 64% to 50%. These changes are shown to be more pronounced in the lower half of the table for the common sample of 22 firms. The importance of non-executive has therefore risen and in that sense their position has been strengthened much as the Cadbury Code of Practice would require. However Table 3 also reveals a substantial variation in experience in our sample boards. The highest share of executives on the board of directors in the full sample in 1995/96 was 67% and the lowest was 25%. In our earlier paper we summarised the position by showing that, for the UK, executive directors represented two-thirds of the board, but in the USA they represented only one-third. We noted that there had been a gradual increase in the proportion of non-executive directors in the UK during the 1970s. This had occurred through a combination of decreased board size and an increased number of non-executive directors. This process has continued, somewhat faster since that time, bringing an equal balance between executive and non-executive directors on average. Whether these differences in the relative positions of executives and non-executives affects the strength of the latter as independent influences on the former must depend however as much upon their characteristics as their numerical strength.

Table 4 allows us to explore this further using the full samples of 27 firms in 1990/91 and 30 firms in 1995/96. The table is based on a detailed examination of the annual accounts of each company for the relevant periods, and of a variety of other sources including *The Directory of Directors*, *Crawfords Directory of City Connections* and *The Hemingford Scott Corporate Register*. The table covers 390

directors in the sample in 1995/96 and 393 in 1980/81. The upper half of the table examines executives and the lower half relates to non-executives. If we consider the non-executives first we find, from the final 3 rows of the table, that they are more likely to hold other directorships than executives, although they hold somewhat fewer on average in the mid 1990s than in 1980/81. They are also older and have spent substantially less time, on average, with the company than have the executives, although they have been board members for similar periods (about 7 years). Whereas the average length of career within that company of an executive was around 17 years in 1996 (compared with 22 years in 1980/81) the comparable figures for non-executives were 6.5 years and 7.5 years, broadly the same as their average length of time on the board. These averages however conceal some important variations. If we consider the background of the non-executives their 'outsider' status becomes compromised. A high and rising number of non-executives are past or present CEOs, or executives, of other larger UK companies. There were 84 of these in 1995/96 compared with 51 in 1980/81, and they had been with the company between 3 and 5 years. A further 19 non-executives in the later year were past executives of the company itself, whose career with their company spanned an average of 21 years, and another 26 were executive directors of other non-financial companies. Table 5 explores this further by showing the percentage distribution across the various types of non-executive director in 1981 and 1996. It reveals that, whilst the proportion of non-executives who were previously executives of their company has fallen from 15% to 10%, the overall proportion of 'insider' non-executives (i.e. current or former executive directors of the same or similar companies) has remained at 55%.

In so far as these non-executives form the pool from which remuneration committees are to be drawn a number of observations are appropriate. First, the presence of significant numbers of 'insider' non-executives does not seem consistent with independent outsider judgements. Second, the presence of so many past or present CEOs of

other large firms raises questions about the extent to which it remains true that "managers determine one another's salaries". Whilst it must be true that experience and seniority are valuable qualities for a non-executive director, the extent to which they share common values about the worth of CEOs as a group has the potential to play an important role in ratcheting up pay levels. The pay that non-executives get in their roles as executives in their 'home' corporations is bound to condition what they regard as reasonable when they serve on remuneration committees. The sharing of common values across senior executives at similar positions in the business and social structure must serve to reinforce this internal reference system (Nichols 1969, Main 1991, Main and Johnston 1993, O'Reilly et. al. 1988, Useem 1984). This tendency will be reinforced to the extent that the remuneration committees on which they serve, rely on consultants' advice based on adjusting clients pay to comparator 'norms', especially where size is a key factor in identifying the norm to be paid (Cosh and Hughes 1997). A further constraint on the independence of non-executive directors is that there is no distinction between them and executives in their legal responsibilities, so that they are an integral part of the board team which they are deemed to be monitoring (Parkinson 1994, Ezzam and Watson 1996). It is certainly the case that the proportion of non-executives on a board of directors appears to play a negligible role in affecting either the sensitivity of pay to performance, the discretionary component of pay, or the likelihood of dismissal following poor performance (Cosh and Hughes 1997). The Greenbury recommendation for a fuller reporting and justification of remuneration packages by non-executive chairmen of remuneration committees is therefore important. It is also important that the method of appointment of non-executives should be as open as possible, and that institutional investors, as significant shareholders, play an active role in the nomination and selection of non-executives. The likelihood of this being carried out by individual institutions is relatively low given the costs of both identifying suitable non-executives and developing mechanisms of consultation with companies in their process of selecting non-executives. There is

however much to be learned about the potential of shareholder activism from the USA and the activities of the US Council of Institutional Investors (founded in 1985) and the California Public Employees Retirement System (CalPERS).

In the UK, the National Association of Pension Funds and the Association of British Insurers are already associated with the establishment of best practice guidelines for their members, stressing the fiduciary duties of financial institutions as shareholders and fund managers. A coordination of their activities especially along the lines of the publication of lists of underperforming companies as practiced by the US Council of Institutional Investors (CII), and the maintenance of a directory of non-executive directors for use in consultation with companies should be encouraged. The publication of underperformance lists could also help in the activation of other shareholders to take their ownership duties more seriously (Monks and Minow 1995, Hawley and Williams 1996). There is evidence to suggest that in the USA such activity by CII and CalPERS has produced improved corporate performance (Nesbitt 1994, Strickland et. al. 1996, Hawley et. al. 1994).

We can now turn to a discussion of the executive directors themselves. The upper half of Table 4 confirms that the stylised facts of CEOs as career insiders remains true. CEOs who were also executive chairmen in 1995/96 have typically been directors for 14 years, and with their companies for a quarter of a century. Interestingly however, CEOs who were not also chairmen, had typically been directors, and with their company, for around half that time, and this was not primarily because of differences in age between the two groups. The Cadbury Code was in particular designed to encourage the separation of the role of CEO and chairman. It is striking that in our 1995/96 sample half of the companies still combined these roles. Table 5 shows that this was a marked decline from the 74% who combined these roles in 1980/81, but suggests that there is still some way to go if the Cadbury objectives are to be met.

In 12 of these 15 cases of a combined role in 1996, the CEO had spent more than two-thirds of his career with the company. This was the case for only 5 of the 15 examples of non-chairman CEOs. Both our 1981 and 1996 samples suggest that the combined role is more likely to occur with long service CEOs whose career has been primarily with that company.

The bulk of executive directors who held neither CEO nor chairman status had been directors for around 5 years and had been with their companies for around 16 years. This was notably less than was the case in 1981 and is only partially associated with a reduction in the average ages of executives over this period. This suggests that there has been some increase in outside recruitment at the earlier pre-board stages of an executives career pattern. This may in time produce a further fall in the average insider career path of CEOs. Even so an average of 16 years service within an organisation is hardly conspicuous evidence of an active inter-company market in senior executive talent.

Table 6 pursues in more detail the provenance of CEOs and other executive directors. It measures the degree to which directors are insiders by calculating the proportion of their careers spent inside their companies. It confirms the insider nature of CEOs. Well over 50% of them spent 2/3 or more of their career with the companies they led in 1980/81 and the same was true in 1995/96. The same picture emerges for the common sample of 22 companies although it is not reported in the table. The table also confirms a decline in the extent to which other executives are insiders. The proportion of those spending 2/3 or more of their careers with the companies on whose board they sit fell from 72% to 50%. The number who came to their present company from executive positions with another firm rose in absolute terms from 11 to 58 between 1980/81 and 1995/96, and in proportionate terms from 5% to around 30% of all executives. In both samples around 5% of executives came to their current position as a result of acquisition of their original company. This confirms the

implication drawn above that there has been an increase in inter-corporate transfer of executives at levels below CEO and that it is at this level rather than at CEO level that an active market is developing.

Although CEOs remain predominantly insiders it appears to be the case that they do not remain as CEOs for extended periods. Table 7 compares turnover of CEOs, other executive directors, and non-executives in two ten year periods for our samples of 27 and 30 firms respectively. Only 11% of our 1981 CEOs had held that position for ten years previously and this fell to 10% for our 1996 sample. Whereas roughly half of CEOs in 1981 were directors of that company a decade earlier, this applied to only 30% of the 1996 CEOs. There was also a higher turnover of non-executives in the later period. Executive turnover was at much the same level in both periods. The significance of these changes in turnover for non-executives is that they indicate that the opportunity for shareholders to influence appointments is increasing and therefore the occasions for shareholders to exercise 'voice' are more numerous.

It is beyond the scope of this paper to enquire into the reasons for CEO turnover and the extent to which it reflects dismissal rather than retirement. A separate study has shown however that as many as a third of CEO departures in UK quoted companies were associated with dismissals due to poor performance in the period 1989-94. The likelihood of this occurring, given poor performance, was however not significantly enhanced by the proportion of non-executives on the board (Cosh and Hughes 1997).

Shareownership

Central to the notion that there is a conflict of interest between executives and shareholders is the idea that the former constitute a professional salaried group with insignificant ownership rights in the companies they lead, and that individual shareholders are powerless to ensure shareholder oriented behaviour. Consequently much has been

made of the need to design incentive structures which include "ownership" benefits, in particular remuneration in the form of stock options. Table 8 provides information on the identity of holders of significant blocks of stock in the companies in our common samples in both 1980/81 and 1995/96. This reveals that there were no boards (as a group) which held over 3% of total equity in our 1980/81 sample and only one board in 1995/96 which did so. In contrast there were 17 such holdings by financial institutions in 1980/81 and 31 in 1995/96. In each case the median value of such holdings was 4%. Clearly then in proportionate terms it is institutions which have the predominant "ownership" stake and this has been increasing over time (in most of our 1996 sample financial institutions held over 75% of the shares).

The holdings of boards are shown in more detail in Table 9, where we provide a breakdown of ownership into beneficial and non-beneficial components, and an analysis including and excluding stock options. Data are provided for the common sample of 22 firms and for the full samples in their respective years. The mean values are distorted by one or two extreme values and so we concentrate on the median values. The picture is quite clear. For beneficial holdings excluding stock options the median percentage of stock held by boards has remained at around 0.03% from 1980/81 to 1995/96. In the former year, adding stock options doubles this to 0.6%. In 1995/96 however, the impact of stock options is to increase holdings by between six and sevenfold so that the median board held 0.24% in the full sample in that year. This is still small in proportionate terms and is dwarfed by institutional holdings. This however under-estimates the incentive implications of directors shareownership, since what matters from that point of view is not the percentage of shares owned as such, but the absolute wealth that shareholdings confer on directors, and its importance relative to other components of the remuneration package.

We can gain a full picture of this aspect of executive shareownership from Table 10. This table shows for both 1980/81 and 1995/96 the percentage distribution, by 1996 market value, of executive and all

directors shareholdings, both including and excluding stock options. Between 1980/81 and 1995/96 the median value of executive directors holdings rose from £4,600 to £76,300. Including stock options raises the median holding to £16,100 in 1980/81 but to nearly £1 million in 1995/96, and the mean holding in that year was over £2 million. Whilst 18.7% of executives held no stock in 1980/81 only 8.4% held none in 1995/96, and only 5.2% held none if we include stock options in the picture. By the latter year 46.5% of executives in our sample were millionaires by virtue of their stock holdings, of which around 40% found themselves in that position because of their options. The data for all directors paint a similar picture although at a more muted level reflecting the absence of options shareholdings by non-executives (except recently retired executive directors).

These share incentive implications are even more marked when we consider CEOs alone. Thus Table 11, which provides a breakdown of the CEO remuneration packages for our full samples in 1980/81 and 1995/96 respectively, shows that whilst the median CEO shareholding including options was worth £43,000 in 1996 prices in 1980/81, it was worth £1,891,000 by 1995/96, compared to median salary plus bonus payments of £172,000 and £640,000 respectively. These medians moreover conceal some extreme payments and shareholding values. thus in 1995/96 the largest beneficial plus option holding was over £29 million, and the highest remuneration excluding option values was over £4 million.

The 1980s and 1990s have therefore clearly seen a step change in the level of remuneration packages of CEOs in the UK and in the role of options as part of that package. Whilst both the levels of remuneration paid to CEOs and the dramatic changes in remuneration which have occurred have raised the intensity of the debate over pay and governance and the legitimacy of such payments, a more particular question is whether either the levels of remuneration offered or its change are related to company performance. The evidence on this is far from reassuring. Company size and changes in size remain much

more significant determinants of executive pay than shareholder performance measures such as accounting rates of return, returns on equity or earnings per share, much as they have done in the 1960, 1970 and 1980s (Cosh 1975, Meeks and Whittington 1975, Main 1991, Conyon and Leech 1993, Cosh and Hughes 1997, Gregg, Machin and Szymanski 1992). This remains true even when share options are included in the remuneration package. The inclusion of stock options in total remuneration naturally makes such measures more sensitive to stock market movements as a whole and to the absolute movements of a firms share price. In that sense pay and share performance may appear more closely linked. What is more relevant however is whether this wider measure of remuneration is related to *relative* performance rather than movements in the market as a whole; recent evidence suggests that this connection remains insignificant (Main, Bruce and Buck 1996). Moreover there is little evidence to suggest that the sensitivity of the pay performance relationship is strengthened by a significant shareholding presence by financial institutions (Cosh and Hughes 1997, Conyon and Leech 1993).

Conclusions

Our analysis of the anatomy of corporate control in the UK in the mid 1990s reveals many similarities with the patterns revealed by our earlier analysis for 1980/81. Boards of Directors of the largest UK corporations remain dominated by executive insiders of one form or another. The majority of executives have spent the bulk of their career with the same firm. This is especially true at CEO level. Non-executives now form half the board, but remain substantially drawn from the ranks of past or present CEOs and other executives of other larger companies, or former executives of the company itself. Boards remain insignificant holders of shares in percentage terms and the predominant group of holders of large blocks of stock remain the financial institutions.

There have however been some significant changes. There has been a substantial widening of the gap between the remuneration of CEOs and the rest of the executive directors despite the fact that the latter are somewhat less likely to be single firm insiders and more subject to an emerging market for executives. Real remuneration in terms of salary and bonus has risen dramatically for the CEOs and this increase is even more substantial when stock options are taken into account. The value of option holdings granted to executive directors as a whole meant that 40% of our sample were stock holding millionaires in the mid 1990s. The absolute value of such holdings by CEOs were even more substantial. The median value of such holdings was approaching £2m in 1995/96 in our sample. The continued domination of CEO posts by insiders and the lack of the development of a particularly active market at CEO level, has meant that governance issues are central to the legitimisation of such substantial changes in reward levels and systems, particularly when options are issued in the context of a rising bull market. The Cadbury and Greenbury reports have correctly stressed this point. They have, within the confines of the unitary board system of the UK, stressed the need for independent scrutiny of remuneration systems. In doing so they have placed particular emphasis on the role of non-executive directors and institutional shareholders, and the need to separate the CEO and chairman's roles. It is noteworthy that we found that in a half of our sample in the mid 1990s these latter roles remained combined. Moreover there is little evidence to suggest that either the proportion of non-executives on the board of directors, or the presence of large institutional investor holdings, affects either the sensitivity of pay to performance or the likelihood of CEO dismissal in the face of poor performance. Given the social and institutional forces surrounding the choice and reappointment of non-executives, and their legal responsibilities as directors of the companies on whose boards they serve, it is perhaps not surprising that they have yet to be identified as a powerful force for executive incentive realignment. We have therefore emphasised the need within the unitary board system for more concentrated action on the part of institutional investors both in

the provision of information to other shareholders about underperforming companies, and in the collation of information about independent non-executives for use in consultation and discussion with companies in the non-executive selection process. We have in particular drawn attention to the impact that such concentrated action may have, based on evidence for the USA. It must be stressed however that this agenda for action is constrained within the confines of a unitary board system, and with responsibilities for intervention and rights of representation based on shareownership or trusteeship alone. It does not address the wider issues of community responsibility or legitimacy raised by Berle and Means over half a century ago and which remain unresolved as we move into the 21st Century.

TABLES

Table 1: The Importance of the Samples

Whole Sample	Anatomy of Control 1980/81	New Sample 1995/96
Number of Companies	27	30
Total Sales (£m 95/96 prices)	212,888	199,679
Total Assets (£m 95/96 prices)	105,663	167,216
Total Employment	2,076,537	1,839,120
% of top 100 Companies		
Sales	49	44
Assets	57	35
Employment	47	45
Common Sample		
Number of Companies	22	22
Total Sales (£m 95/96 prices)	190,515	135,849
Total Assets (£m 95/96 prices)	97,250	93,624
Total Employment	1,742,166	1,234,928
% of top 100 companies		
Sales	44	30
Assets	52	20
Employment	39	30

Table 2: Performance 1980/81 to 1995/96

Common Sample	**Median Period % Change** (adjusted for inflation)
Sales	-19.7
Assets	-15.9
Profits	4.1
Market Value	250.9
Employment	-45.4
Employees Remuneration	-2.9
Average Employee Pay	65.1
Directors Emoluments	64.5
Chief Executive Pay	197.9

Table 3: Board Size and Composition

	Highest		Lowest		Mean		Median	
	1980/81	1995/96	1980/81	1995/96	1980/81	1995/96	1980/81	1995/96
Whole Sample								
All directors	29	24	9	8	14.6	13.2	14	13.0
Executive directors	21	14	4	2	9.3	6.4	9	6.0
Non-executives	9	11	3	4	5.3	6.6	5	6.0
Proportion of executives	0.78	0.67	0.27	0.25	0.63	0.48	0.64	0.50
Common Sample								
All directors	29	24	9	8	14.3	13.0	13.5	12.0
Executive directors	21	14	3	2	9.2	6.5	8.5	6.0
Non-executives	9	11	3	4	5.1	6.5	5.0	6.0
Proportion of executives	0.78	0.62	0.27	0.25	0.63	0.49	0.66	0.50

Table 4: Types of Director and their Characteristics in Giant Companies in the UK - 1981 and 1996

Director Type		Number		Average no. of outside directorhsips		Average age		Average years as director		Average years with company	
		1981	1996	1981	1996	1981	1996	1981	1996	1981	1996
Number of companies		27	30	27	30	27	30	27	30	27	30
Executive											
CEO	chairman	20	15	2.3	1.2	56.9	58.7	11.3	13.9	22.9	25.9
	not chairman	7	15	0.9	1.1	53.1	55.3	7.0	6.6	13.7	12.4
Other executive	chairman	6	6	4.8	2.0	62.7	60.7	8.7	12.5	12.5	17.5
	not chairman	218	155	0.6	0.5	55.5	52.0	5.5	5.0	22.7	16.0
Non-executive											
CEO or Executive Director of other *Times* 1000		37	56	3.3	2.1	58.7	56.3	3.3	3.6	3.3	3.6
Past CEO or Executive Director of other *Times* 1000		14	28	4.2	2.9	63.3	62.5	5.6	6.1	5.6	6.1
Executive director of other non-financial		6	6	3.9	2.2	64.7	59.5	5.5	5.0	5.5	5.0
Director of financial company		28	26	4.1	2.2	61.0	60.0	7.3	5.3	7.3	5.3
Family holding		0	2	-	0.0	-	72.0	-	42.3	-	44.8
Past executive of this company		21	19	2.7	2.6	64.2	60.6	16.4	12.0	25.5	20.7
Other non-executive		36	62	2.4	2.5	62.0	61.6	3.6	4.4	3.6	4.4
All CEO		27	30	1.9	1.2	55.9	57.0	10.2	10.2	20.5	19.2
All executive		251	191	0.9	0.6	56.0	53.1	6.1	6.1	21.9	16.5
All non-executive		142	199	3.3	2.4	61.4	60.0	6.1	5.7	7.5	6.5
All directors		393	390	1.7	1.5	58.9	56.6	6.1	5.9	14.9	11.2

Table 5: Independence of UK Boards 1981 and 1996

	1981 (%)	1996 (%)
Combined Roles of CEO and Chairman		
CEO and Chairman combined	74	50
CEO and separate Non-Executive Chairman	4	30
CEO and separate Executive Chairman	22	20
Source of Non-Executives		
Past Executive Director of this company	15	10
CEO or Executive Director of other *Times* 1000	26	28
Former CEO or Executive Director *Times* 1000	10	14
Executive Director of other non-financial	4	3
Executive Director of financial company	20	13
Former civil servant or politician	12	12
Overseas	6	14
Other	7	6
'Insider' Non-Executives	55	55

Table 6: Previous Corporate Experience of Executive Directors - 1981 and 1996

	1981			1996		
	CEOs	Other Executive Directors	All Executive Directors	CEOs	Other Executive Directors	All Executive Directors
Total number	27	224	251	30	161	191
Number with more than 2/3 of career within company	14	63	77	17	69	86
From executive post in other company	8	11	19	11	58	69
With another company acquired by this company	3	13	16	1	12	13
% of those identified with more than 2/3 of career with this company	56	72	69	59	50	51
Other or unknown	2	137	139	1	22	23
% not identified	7	61	55	3	14	12

Table 7: The Stability of UK Board Membership, 1971-1981 and 1986-1996

	% of directors who remained on the board: 1971-1981	1986-1996
CEOs remaining as CEOs	11	10
CEO remaining on the board	48	30
Other executive directors	20	20
Non-executive directors	25	16
All directors	24	18

Table 8: Major Shareholdings 1981 and 1996

	1981 Number of holdings	1981 Sample Median[a] % shares held by these holdings	1996 Number of holdings	1996 Sample Median[a] % shares held by these holdings
Holdings ≥ 3%				
Board	0	-	1	4.1
Internally-managed fund	1	17.7	2	6.7
Board + IMF[b]	1	17.7	2	6.4
Financial institutions	17	3.9	31	4.0
Other	3	19.6	7	7.5
Total	21	4.1	40	4.9
Number of companies	22	22	22	22

a The median values shown take account only of companies with such a holding. Therefore only in the two rows for financial institutions and total holdings greater than 3% are all the sample companies taken into account.

b Internally-managed funds (IMFs) are those where the voting powers associated with the stockholding rests with the company or the participants themselves rather than with an external agency such as a bank.

Table 9: Board Shareholdings, 1981 and 1996

Measure of board shareholding		1981 Common Sample	1981 Full Sample	1996 Common Sample	1996 Full Sample
% of shares held beneficially					
excluding stock options	Mean	0.08	0.07	0.23	0.29
	Median	0.04	0.03	0.03	0.03
including stock options	Mean	0.11	0.12	0.43	0.48
	Median	0.07	0.06	0.26	0.24
% of shares held beneficially and non-beneficially					
	Mean	0.17	0.19	0.75	0.71
	Median	0.07	0.06	0.29	0.26

Table 10: The Size of Directors' Shareholdings 1981 and 1996

Range of Market Value 1996 prices (£,000)	Percentage of directors in each market value range							
	Executive Directors				All Directors			
	Excluding stock option shares		Including stock option shares		Excluding stock option shares		Including stock option shares	
	1981	1996	1981	1996	1981	1996	1981	1996
0	18.7	8.4	16.3	5.2	19.6	16.2	18.1	14.4
0 - 2	13.4	0.0	9.8	0.0	13.6	0.8	11.4	0.8
2 - 5	13.4	4.7	8.7	1.0	15.5	7.9	12.3	6.2
5 - 10	12.9	5.8	8.8	0.0	12.9	10.3	10.3	7.4
10 - 20	13.9	5.2	8.9	2.1	12.9	9.7	9.8	8.2
20 - 50	14.1	19.4	13.6	2.6	12.3	18.2	12.0	9.7
50 - 100	4.7	14.1	8.7	1.6	5.5	10.0	7.9	3.3
100 - 1000	6.5	36.6	21.8	40.8	5.5	23.1	15.3	25.1
> 1000	2.4	5.8	3.4	46.6	2.2	3.8	2.9	24.9
Total %	100	100	100	100	100	100	100	100
Total Number	251	191	251	191	393	390	393	390
Market values (£,000)								
Mean	286.9	1012.4	345.0	2041.3	205.9	1065.1	243.1	1599.6
Median	4.6	76.3	16.1	966.0	5.3	26.0	8.8	104.7

Table 11: Shareownership and Remuneration of CEOs 1981 and 1996

(£,000) 1996 Prices	Smallest	1981 Median	Largest	Smallest	1996 Median	Largest
Market Value of Holdings						
Beneficial	-	-	-	8	284	29,427
Beneficial + options	0	43	61,175	678	1,891	29,427
Remuneration						
Base salary	-	-	-	298	455	1,923
Bonus	-	-	-	0	151	1,923
Other	-	-	-	0	16	270
Remuneration (excluding stock options value and pensions)	128	172	594	349	640	4,116
Number of CEOs		27			30	

Note: In 1996 the minimum, median and maximum ratios of bonus to remuneration were 0%, 21% and 56% respectively.

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