Remunerating executives for long-term value

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Framing and purpose

Executive remuneration has grown more complex, more costly and less defensible over the past two decades: not despite the governance reforms intended to constrain it, but in part because of them. This paper examines the orthodoxies that have shaped that trajectory; the assumptions about attribution, alignment, incentivisation, labour markets, shareholder primacy, quantification and conformity that boards and their advisers tend to accept as settled, but that the evidence does not support.

The paper does not offer a template for remuneration design. Its purpose is more fundamental: to invite boards and their advisers to interrogate the premises on which current practice rests before reaching for familiar solutions. Regnan's view is that the most consequential improvements in remuneration governance will not come from refining existing structures but from reconsidering whether those structures serve their stated purpose. For the same reason, the paper does not seek to showcase examples of supposed best practice. To do so would risk encouraging imitation where fresh judgement is required, and substituting a new template for the critical reappraisal the subject demands.

An earlier version of this paper was shared in confidence with a number of companies and governance practitioners whose experience of remuneration design in listed company contexts informed its development. Respondents included remuneration committee members and chairs, company secretaries, investor relations professionals and members of a leading corporate governance institute. Their observations, offered in confidence and reflected here without attribution, ranged from affirmation of the paper's central argument to constructive challenge of its framing and practical implications. Where that challenge was persuasive, it has been addressed in the text. Regnan is grateful to all those who gave their time and attention to this work.

Introduction

Regnan has maintained a considered position on executive remuneration since 2007. Our original position paper, Remunerating Executives for Shareholder Value*, published in 2013, advanced an approach that:

- Gives primacy to the talent management objective of remuneration, and reports the rationale for each pay element in that context;
- Recognises that executives are employees of the company and treats any moves to pay them otherwise as exceptions requiring specific and compelling rationale;
- Eschews complexity, which often leads to plan components being devalued by executives and misunderstood by stakeholders;
- Recognises that many apparent constraints on the senior executive labour market are attributable to convention rather than reality, and that this has contributed to disproportionate growth in executive pay;
- Recognises that overall quantum can send a material signal to the market, to employees and to other stakeholders, with potential unintended consequences;
- Accepts that executives for whom pay is the primary driver are often ill-suited to leadership, and that pay is not the only means by which esteem can be communicated.

Most fundamentally, Regnan challenged the orthodoxy that the executive pay experience should directly parallel the shareholder experience; a belief instrumental in remuneration plans that have delivered windfalls or shortfalls attributable to circumstances outside the executive's control. Regnan accepts the considerable body of research demonstrating that it is rarely possible to attribute company performance over a predetermined period directly to an individual's efforts.[1]

The intervening period has reinforced rather than weakened these propositions. More generally, executive pay has continued to escalate across major markets.

Across Australia, the United Kingdom and the United States regulators and standard-setters have strengthened governance frameworks: binding shareholder votes on remuneration policy in the UK, the introduction of the two-strike rule in Australia, enhanced pay-versus-performance disclosure requirements in the US [2], and mandatory CEO pay ratio reporting in the UK. Malus and clawback provisions have been tightened in each market, and the European Union's Shareholder Rights Directive II has extended similar disciplines across continental Europe.

* Wilson, A., & Peres da Costa, S. (2013). Remunerating Executives for Shareholder Value. Sydney: Regnan.

Yet despite this regulatory activity, the underlying dynamics of pay escalation, benchmarking-driven inflation and incentive complexity that the 2013 paper identified have proved remarkably persistent. ESG-linked remuneration has introduced further complexity, the effectiveness of which is increasingly questioned.[3] And high-profile controversies; at BP, Thames Water, Persimmon and elsewhere; have demonstrated that executive pay is no longer experienced as a private contractual matter but as a public signal with material consequences.[4]

This paper retains the core principles of the 2013 original; remuneration as a talent-management tool, with an emphasis on simplicity, restraint and internal coherence; but updates them in light of more recent evidence and practice. The evidence base has been refreshed throughout, and four additional orthodoxies are examined: shareholder primacy, highlighting the social-licence dimension of executive pay; quantification, questioning how a preference for numerical targets can distort governance; the limits of incentivising sustainability, analysing the structural weaknesses of ESG-linked remuneration; and conformity, assessing how proxy-advisor guidelines and market templates shape plan design.

The principles section has been expanded to reflect Regnan's recognition that sustainability-related risks may at times warrant integration into pay; that qualitative objectives can be governed using an evidential rather than purely numerical standard; and that guidance on social licence, labour-market assumptions, discretion, conformity pressures and restraint on quantum has become increasingly important.

A further dimension examined in this paper is the role of external conformity pressures: the gravitational pull of proxy advisory frameworks and market templates that, over time, has contributed to the entrenchment of structures that boards themselves often recognise as poorly suited to their circumstances. Where individual reform efforts fail, it is frequently because the conditions that sustain existing practice operate at the system level rather than within any single company.

As in 2013, Regnan offers no prescriptions but provides context, evidence and principles to support the exercise of informed board judgement.

How to read this paper

The main analytical section examines a series of orthodoxies that have shaped executive remuneration design, including attribution, alignment, incentivisation, labour-market assumptions, shareholder primacy, quantification, sustainability-linked pay and conformity to external advisory expectations. The subsequent section, Principles for Judicious Remuneration Design, distils this analysis into principles-based guidance intended to support informed board judgement and the disciplined exercise of discretion, rather than prescribe a single model of best practice.

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Overview

The original paper was prompted by the global financial crisis, which exposed numerous instances of senior executives being generously rewarded despite decisions demonstrably damaging to company value over the longer term. The corrective measures adopted since have relied overwhelmingly on amplifying the correlation between executive reward and financial measures such as shareholder returns supplemented, more recently, by environmental and social targets attached to incentive structures.

Preventing inappropriate outcomes remains important. However, the cumulative effect has been remuneration arrangements of considerable complexity, resting on assumptions about attribution, alignment and motivation that the evidence does not support.[5] This simplified understanding of alignment overestimates the extent to which strong performance can be effected by an individual, and is founded on erroneous assumptions about the impact of contingent rewards on the open-ended, judgement-intensive work that characterises senior leadership.[9]

Allowing executive pay to depart from the talent management frameworks underpinning pay for other employees is not justified by the evidence.[7, 8] Of greater concern is that it produces unintended consequences operating to the detriment of value: escalating quantum driven by benchmarking conventions, pro-cyclical retention pressures, symbolic sustainability adoption, and a widening gap between executive reward and the experience of employees and wider stakeholders. As institutional investors with a long-term interest in company value, Regnan calls on directors to recognise these dynamics and to redress them progressively as opportunities arise.

The orthodoxy of attribution

CEO pay often departs markedly from the principles that guide pay for other employees, both in structure and in quantum, on the assumption that the role is uniquely positioned to create or destroy value. That assumption contains an element of truth: chief executives do exercise unusual authority over strategy, capital allocation, talent and organisational priorities. But it does not follow that company outcomes can be cleanly attributed to them, nor that pay can be calibrated precisely to their individual contribution.[1]

Corporate performance reflects a dense interaction of factors beyond any one executive's control, including inherited assets and capabilities, organisational culture, predecessor decisions, competitor conduct, macroeconomic conditions, regulation and politics. The degree of executive influence also varies by sector, business maturity, ownership structure and market context, so the "CEO effect" is neither fixed nor uniform across firms — and is likely more tractable where an executive is leading a restructuring, post-acquisition integration or operational turnaround than in a mature, stable business where inherited strategy and organisational momentum account for a substantial share of outcomes.[10]

These realities make it difficult to estimate an individual CEO's contribution in advance. They also make it difficult to assess performance after the event, because the relevant counterfactual; what would have happened under the same circumstances with a different CEO; is rarely observable.[1, 11] This is one reason the literature has long warned that executives are often rewarded not only for skill but also for luck, especially where governance is weak.[12]

The problem is compounded by attribution bias. In ordinary performance appraisal, managers are encouraged to guard against over-ascribing outcomes to visible individuals while underweighting system effects and external conditions. Yet at the top of the organisation the opposite tendency often prevails: success and failure are too readily read back into narratives about leadership quality, even where outcomes may reflect circumstances as much as judgement.[13]

The implication is not that CEOs are interchangeable or irrelevant. It is that remuneration design should recognise the limits of attribution. Where boards overstate the precision with which individual contribution can be identified, they risk paying for outcomes that owe as much to context, inheritance or good fortune as to executive skill.[11]

The degree of managerial discretion; and therefore the plausibility of attributing outcomes to individual executive action; varies materially with the state of the business. In a restructuring, post-acquisition integration or operational turnaround, attribution is more tractable and differentiated pay design more defensible. Even in these circumstances, assertions that suitable talent is scarce should not be accepted at face value. They should be supported by evidence, including a genuinely broad and well-tested search for candidates.

The Orthodoxy of Alignment

Linking a substantial proportion of executive remuneration to shareholder returns is typically justified as aligning executive and shareholder interests to mitigate agency costs. In the UK, a common practice is to base long-term incentive plans at least in part on total shareholder return relative to a peer group. The theory is intuitive: if executives share in shareholders' gains and losses, they will act more like owners. In practice, however, this form of alignment is far more uncertain than its advocates acknowledge.[14]

The extent to which variable pay causes an executive to feel they have genuine "skin in the game" depends on factors that differ markedly between individuals: their level of fixed pay, personal wealth, life stage, risk appetite and career horizon.[7] [8] Continued employment and reputational standing may matter more to any given executive than the marginal incentive created by an equity award. Recent field evidence confirms this: directors and investors surveyed by Edmans, Gosling and Jenter report that intrinsic motivation and reputation are stronger motivators than incentive pay, and that pay matters to CEOs principally as a marker of fairness rather than as a driver of effort.[7]

The chosen instrument compounds the problem. Total shareholder returns (TSR) is an outcome metric that executives cannot directly control, and evidence suggests it is a poor driver of the financial and operational decisions boards actually want to encourage.[16]

Because TSR reflects market-wide movements and sector rotation alongside company-specific performance, it can deliver windfall gains when conditions are favourable and penalise executives for circumstances beyond their influence when conditions deteriorate.[17] This makes TSR-linked pay inherently pro-cyclical: it inflates rewards in bull markets and erodes retention incentives in downturns, precisely when continuity of leadership may matter most.

The resulting retention gap is frequently filled by ad hoc retention payments or re-grants, each of which undermines the alignment rationale that justified the original award. A further concern is that boards, seeking to refine alignment, layer additional quantitative metrics onto incentive plans. The added complexity often distorts intended outcomes and can deliver results neither board nor executive anticipated, without improving the relationship between effort and reward.[14]

The implication is not that executives should hold no equity. Reasonable long-term shareholding can reinforce commitment. But boards should distinguish between genuine long-term ownership and the mechanical overlay of TSR hurdles on incentive plans, which risk creating an appearance of alignment while delivering outcomes that owe more to market conditions, plan complexity and cognitive biases than to executive skill.[16]

This mismatch is compounded by a temporal asymmetry that is rarely acknowledged: investors assessing remuneration outcomes, including in annual advisory votes, tend to anchor on recent share price performance, while the long-term incentive plans being assessed vest over three to five year periods that extend well beyond the vote. A plan that appears well-designed at grant may attract criticism at vesting because intervening market conditions have delivered unexpected outcomes; one that appears generous at vesting may have been entirely appropriate when set. TSR's appeal as a metric lies partly in its legibility to shareholders at the point of the vote; but that legibility reflects a short-term window that may have little bearing on the multi-year period the long-term incentive (LTI) was designed to govern.

The orthodoxy of incentivisation

The idea that conditional financial rewards can incentivise executives to deliver superior performance is at odds with one of the most robust findings in behavioural and organisational psychology. Meta-analytic evidence consistently shows that anticipated, performance-contingent rewards undermine intrinsic motivation for complex, non-routine tasks; precisely the kind of work expected of senior leaders; by narrowing focus, promoting short-termism and increasing risk-taking.[18]

These findings apply with particular force at chief executive level. The work of a CEO is inherently open-ended and judgement-intensive: setting strategy, navigating uncertainty, managing diverse stakeholders and making trade-offs across time horizons. These are conditions under which extrinsic incentives are least effective and most likely to distort behaviour.[19] A longitudinal survey of senior executives confirms the practical implications: many executives report discounting the value of long-term incentive plans (LTIP) substantially, and the proportion of executives who regard their LTIP as an effective incentive fell from 60 per cent in 2012 to just 41 per cent by 2024.[9] When there is a persistent disconnect between effort and reward; the natural result of the attribution and alignment problems discussed above; variable pay ceases to motivate and simply becomes noise.[18 9]

These drawbacks combine with the problems of attribution and alignment to make conventional incentive payments counterproductive in many cases.

In practice, the uncertain link between an executive's decisions and the eventual pay outcome leads executives to discount variable elements heavily.[9] Partly in response, fixed pay has continued to rise despite the growth of at-risk elements, which in turn inflates the variable components calculated as a percentage or multiple of base salary.[20] The result is a sustained escalation of overall executive pay. In the United Kingdom, median FTSE 100 CEO remuneration has reached record levels for the third consecutive year.[2] In the United States, median S&P 500 CEO total direct compensation rose to approximately $17 million in 2024, with the CEO-to-worker pay ratio climbing to 192:1.3 In Australia, median realised pay for ASX 100 CEOs reached $4.15 million in FY24, the highest since FY21, with CEO pay running at approximately 55 times the average Australian wage.[4]

That widening gap is not an incidental side-effect; it is a predictable consequence of a system in which each element of incentive design, intended to moderate agency costs, instead provides fresh justification for ratcheting total compensation upward.[20]

None of this means boards should ignore pay design. But it does suggest that complexity and conditionality are more likely to inflate cost than to improve performance. The evidence points instead toward simplicity, restraint and a greater reliance on the intrinsic motivations that already attract effective leaders to senior roles.[9 14]

The orthodoxy of buying the best

A persistent defence of high executive pay is that boards must offer market-leading packages to attract and retain scarce talent. The assumption is that a competitive labour market sets the price, and boards that do not pay at or above the median risk losing their most capable leaders. In practice, this reasoning both overstates the scarcity of qualified executives and provides the mechanism by which pay escalates beyond any defensible relationship with performance.[20]

The benchmarking process itself drives inflation. When most companies aim to pay at or above the peer-group median, the inevitable result is a ratchet: each round of benchmarking raises the floor for the next.[21] Recent research confirms that compensation disclosure, rather than restraining pay, can actively accelerate escalation by reducing uncertainty about peers' pay and thereby strengthening CEO bargaining leverage.[22] Peer groups themselves are often constructed aspirationally, including larger or higher-paying comparators, and firms have been shown to add higher-paid peers and drop lower-paid ones even after enhanced disclosure requirements.[23 24]

Nor does the evidence support the idea that paying more yields better outcomes. MSCI's analysis of US chief executives found that those overseeing the strongest shareholder returns received the lowest awarded pay, and that the best-performing CEOs earned only marginally more in realised pay than those delivering average performance; a finding consistent across both a decade-long study concluding in 2014 and a subsequent analysis extending to 2020. [25 37] This is consistent with the broader pattern: the link between total pay quantum and long-term shareholder returns is weak at best, and in many studies negative.[26]

Beyond a certain threshold, pay appears to function as a marker of esteem rather than as compensation for effort or skill.[7 8] But such pre-emptive esteem carries costs. Pay structures and quantum that differ markedly from those of other senior executives can exaggerate hierarchical distance, impair team cohesion, subdue contributions from others and distort succession planning.[27] There is, moreover, a well-established body of evidence that non-financial factors; the intrinsic satisfactions of the role, reputational capital, public standing; play a significant part in attracting and retaining senior talent. [7 8 9]

Boards should be willing to rely on these motivations more openly and to resist the convention that quantum alone secures commitment. [7 8]

This is not to deny that pay remains a genuine constraint in specific circumstances. Executives conduct their own assessment of the market before accepting roles, and a package perceived as materially below prevailing rates may present a barrier to appointment regardless of the non-financial attractions of the position. The argument is not that remuneration can be set without reference to the market, but that market reference should be interrogated rather than accepted uncritically: tested against the specific individual, the specific role and the specific pool of candidates that a genuinely broad search would surface. Where retention difficulties arise, they may reflect artificial constraints on the candidate pool as much as genuine market pricing, and broadening recruitment criteria would increase competitive tension while weakening the benchmarking dynamics that sustain inflationary norms.

The lack of diversity in executive appointments itself suggests that the senior labour market is constrained by artificial barriers; conventions about experience, background and profile; rather than by genuine scarcity of qualified candidates. Broadening the pool would increase competitive tension and weaken the ratchet dynamic that currently sustains inflationary pay norms.[27]

The orthodoxy of shareholder primacy

Executive remuneration is often defended as a matter properly confined to boards and shareholders. Formally, that is correct: boards determine pay structures, and shareholders vote on remuneration policy and implementation. But it does not follow that executive pay is experienced only as a shareholder matter. In practice, remuneration outcomes are also interpreted by employees, customers, regulators and the wider public as signals about fairness, restraint and the company's regard for its broader obligations.[7]

This should not be surprising. The same remuneration outcome can be understood simultaneously as a contractual arrangement between company and executive, a governance matter for shareholders, and a public signal about who bears pain and who is insulated from it. Recent research suggests that executive pay is constrained not only by formal governance mechanisms but also by external legitimacy costs: the reputational, social and economic penalties that arise when wider stakeholders regard remuneration as excessive or undeserved.[7, 28] Remuneration may be set in the boardroom, but its legitimacy is tested outside it.[7]

These pressures become most acute in periods of controversy. What attracts scrutiny is not simply a large number, but a visible mismatch between executive reward and the outcomes experienced by others. BP's chief executive received more than £10 million for 2022, and the scale of pay drew criticism during the cost-of-living crisis and a period of elevated energy bills and sector profits in the UK.[29, 30] At Thames Water, proposed retention awards for senior executives became politically and publicly contentious, and the company later halted its bonus scheme for senior management amid wider concerns over environmental performance, financial resilience and customer outcomes.[31, 32] At Qantas, former chief executive Alan Joyce received a final deferred award of A$3.8 million in 2025 despite a tenure that ended in regulatory sanction, reputational damage and the unlawful termination of ground staff — a sequence that had already prompted the board to reduce his departure payment by A$9.3 million following an external governance review.[36]

The point is not that boards should set remuneration by reference to headlines or social media reaction. It is that social licence now forms part of the operating context in which executive pay must function. A package that appears defensible in narrow contractual terms may still be value-destructive if it undermines employee trust, customer goodwill, public credibility or regulatory tolerance.[7] This is not an argument for populism. It is an argument for realism: beyond a certain threshold, remuneration is no longer merely a private price for executive labour, but a public signal whose cost can rise sharply when controversy exposes a gap between what executives are paid and what others are being asked to bear.[7]

The orthodoxy of quantification

A further orthodox assumption in contemporary remuneration design is that performance is only governable; and accountability only meaningful; where outcomes can be expressed numerically. This rarely stated premise nonetheless shapes which objectives are admitted to incentive plans, which are excluded, and how boards frame expectations of executive leadership. It privileges what is measurable over what is material and narrows the remuneration committee's field of vision to those aspects of performance most easily expressed as numbers.

The consequences are material. Treating quantification as a precondition of inclusion leads remuneration frameworks to underweight factors that resist numerical reduction but are critical to long-term productive capacity: the quality of stakeholder relationships, the resilience of organisational culture, the adequacy of succession planning, the integrity of risk governance, the capacity for strategic adaptation under uncertainty. These conditions often underpin the delivery of financial targets, yet their erosion is typically recognised only in retrospect, once the cost is already incurred.

The intellectual error is to conflate measurability with rigour. A numerical target is not inherently more rigorous than a qualitative one; it is merely more convenient. A target can be precisely quantified yet trivially easy to achieve, or achieved in ways that destroy value. Conversely, a qualitative objective; a successful business-line repositioning, resolution of a material regulatory exposure, or rebuilding of a damaged workforce relationship; may be more demanding, more consequential and more directly connected to executive judgement than any numerical key performance indicator (KPI) in the same plan. The discipline lies not in the metric's form but in the clarity of the expectation, the quality of evidence and the credibility of the assessment.

A further structural risk is the incentive to force qualitative objectives into numerical proxies; engagement scores, diversity percentages, emission reduction figures; that satisfy formal requirements without reliably capturing the outcome the board intends to incentivise.[33 35]

Regnan's position is that this quantification orthodoxy, though understandable as a response to historic opacity in executive pay, has become a constraint on effective remuneration governance. It narrows committee discretion, distorts the composition of incentive plans and offers a false precision that may obscure rather than illuminate the quality of executive performance. A more intellectually honest framework would accept that some of the most important things a board asks its executives to do cannot be reduced to a number, and that the remuneration committee's task is to govern performance in its full complexity rather than in its quantifiable dimensions.

The limits of incentivising sustainability

The preceding orthodoxies of attribution, alignment and incentivisation apply with equal force to the growing practice of linking executive pay to environmental and social targets. The logic is familiar: if boards want executives to prioritise sustainability, they should attach remuneration to it. Yet the same structural weaknesses that undermine financial performance incentives are often amplified when applied to environmental and social outcomes, especially where the targets are difficult to measure, weakly weighted or heavily dependent on board discretion.[33 34]

A first problem is rent extraction. ESG-based remuneration can create additional channels for self-serving pay design, particularly where targets are qualitative, disclosure is limited and assessment is highly discretionary.[33] In such circumstances, rewards can become detached from substantive outcomes while still being presented as evidence of responsible governance. Vague and weakly monitored ESG measures risk becoming opaque compensation components rather than effective incentives, providing cover for awards that shareholders cannot meaningfully assess. [34]

That problem is reinforced by the limited economic significance of most ESG-linked incentives. Research finds that, once the executive's wider incentive portfolio is taken into account, the median ESG component falls to only 0.2 per cent in the US sample he studies.[35] FTSE 350 practice follows a similar pattern: ESG-linked elements are typically modest in scale, more commonly attached to annual bonuses than to long-term plans, and generally too small to alter behaviour materially.[33] A measure that is too small to change conduct meaningfully may still be large enough to widen discretion and justify rewards that shareholders cannot easily verify.[33 35]

A second problem is symbolic adoption. FTSE 350 evidence shows that ESG metrics frequently reward procedural tasks; publishing disclosures or submitting plans; rather than substantive environmental or social improvements.[33] Sustainability strategy is identified as a common indicator, and in a number of cases companies have linked pay to Task Force on Climate-related Financial Disclosures (TCFD)-related reporting even where such reporting had already become expected or mandatory.[33] In these cases, remuneration risks rewarding the appearance of commitment rather than difficult operational change.

This also compounds the attribution problem addressed earlier in the paper. Much ESG process work cannot plausibly be attributed to the distinctive effort or judgement of the chief executive in the way remuneration design assumes. Publishing a climate disclosure, conducting a gap analysis or implementing a supplier code will usually depend on specialist teams, advisers and internal systems rather than on some unique executive contribution. That a chief executive may legitimately direct such work does not mean they should receive additional financial reward for its completion: if the outcome depends on the efforts of others, the executive's marginal contribution does not meet the threshold that justifies a contingent award, and such measures are therefore poorly suited to a pay instrument ostensibly designed to reward scarce judgement, prioritisation and leadership.[33]

There is also a double-cost problem. The company first pays for the underlying exercise itself through consultants, systems, modelling, legal review and management time. It then pays again by rewarding the executive for having overseen completion of that exercise. Where the output is not followed by genuine strategic reorientation or measurable operational change, shareholders have effectively paid twice for an outcome that amounts more to process or presentation than to performance.[33]

None of this is to deny that sustainability may be material to long-term value, or that boards should seek to embed it in executive decision-making. The concern is with the method. Current practice places ESG metrics overwhelmingly in annual bonus structures, with only a smaller subset of companies incorporating them into long-term equity awards, 191 FTSE 350 companies have been recorded using ESG indicators in annual bonuses, compared with 68 in LTIPs.[33] That leaves many companies with the form of ESG-linked remuneration, but not much of its substance.[33 34 35]

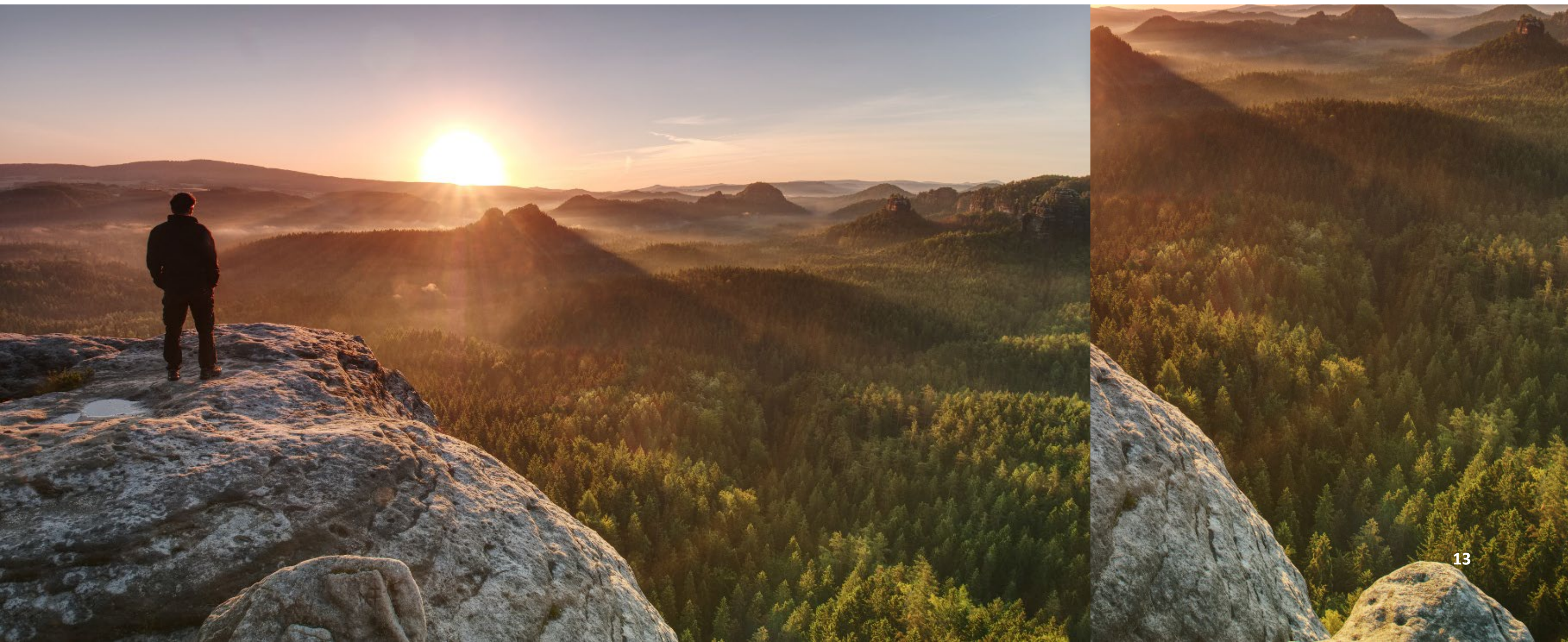
Where ESG metrics are used at all, they should be few, business-specific, objectively assessable and tied to decisions that genuinely require executive judgement. They should not reward routine compliance, generic disclosures or procedural activity that the company ought to undertake in any event. Otherwise, the inclusion of sustainability in pay design risks adding cost, complexity and symbolism without materially improving accountability or outcomes.[33 34]

The orthodoxy of conformity

The persistence of the orthodoxies examined in this paper is not incidental; it reflects, in part, the external advisory ecosystem surrounding remuneration governance. Two distinct actors are involved: proxy advisory firms, whose voting policy guidelines function as de facto design templates across major equity markets; and remuneration consultants, whose influence on pay plan design operates primarily through the peer group construction and benchmarking conventions that entrench the ratchet dynamic described elsewhere in this paper. [21,22,23,24]

ISS and Glass Lewis publish voting policies that set out in detail the remuneration plan features they will support or oppose. Research confirms that companies adjust compensation plans in advance of shareholder votes to align with proxy advisor policy requirements; a pattern of anticipatory conformity that, over time, shapes plan design from inception rather than merely at the margins.[38] The result is a gravitational pull toward structures that can be efficiently processed within a generalised framework; defined set of metrics, defined performance periods, standardised deferral schedules; at the expense of bespoke arrangements that may be more appropriate to the company's circumstances but resist easy classification.[38,39] As passive investing has grown, this effect has intensified: passive managers, whose voting at scale is more readily coordinated through proxy advisor guidance, amplify the effective voting weight attached to guideline compliance.[40]

The combined result is a conformity equilibrium in which the rational course for a remuneration committee is to adopt structures that meet adviser expectations rather than those suited to the business; one in which conformity carries no cost and independent judgement carries reputational and procedural risk with no corresponding upside. The orthodoxies examined in this paper are not merely intellectual errors; they are, in part, the predictable output of a system that rewards standardisation and penalises the exercise of judgement that effective remuneration governance requires.



Principles for judicious remuneration design

The orthodoxies examined in this paper; of attribution, alignment, incentivisation, buying the best, shareholder primacy and ESG-linked pay; are not independent distortions. They are mutually reinforcing features of a system whose cumulative adaptations, each defensible in isolation, have, in aggregate, moved progressively away from its stated purpose.

Remuneration was originally conceived as a tool for talent management: attracting, retaining and motivating individuals suited to senior leadership. Over time, that purpose has been overlaid with increasingly complex mechanisms justified by agency theory, benchmarking convention and, most recently, sustainability signalling, each of which has expanded the cost of executive pay without reliably improving the quality of executive decision-making.[14]

The concern advanced in this paper is not with the use of incentive structures, equity-based awards or quantitative reference points as such. These can serve as legitimate governance tools when applied with deliberate judgement and in a manner suited to the particular circumstances of the business. The concern is with their mechanical application as ends in themselves, disconnected from the specific context, leadership requirements and operating conditions that should determine how any such instrument is used.

Boards seeking to restore a more defensible approach need not abandon market practice entirely. But they should be willing to depart from convention where convention lacks evidential support. The following principles, updated from Regnan's original guidance, are offered not as prescriptions but as a framework for the exercise of informed board judgement.

Executives as employees

Executive pay arrangements should default to consistency with the principles that govern pay for other employees within the organisation. Where job evaluation frameworks determine pay below executive level, clear and explainable relativities between those levels and key management personnel should be evident. The CEO pay ratio, now mandatory for UK companies with 250 or more employees, provides a useful, if imperfect, discipline for this purpose.[2] Departures from internal consistency require specific justification rooted in the demands of the role, not merely in external benchmarking.

Business strategy as the anchor

Where pay structure or quantum departs from that of other employees, it should do so in a manner demonstrably connected to the business strategy and the executive's specific role within it. Boards should articulate what kind of leadership the business requires at this stage of its development; whether that is expansion, integration, turnaround, steady stewardship or managed decline; and ensure that remuneration reflects those requirements rather than a generic incentive template.

- What are the goals for the company? What kind of growth? What is the risk appetite? Will the CEO be leading wholly new endeavours; expansion into new markets, development of different income streams, or effecting a turnaround or integration?

- Alternatively, is the CEO taking the reins of a mature, stable business, with limited opportunity for growth? Does that context warrant materially different pay design?

Internal resources, external circumstances and the exercise of discretion

Performance conditions attached to variable pay should reflect factors genuinely within the executive's power to influence. Boards should model how pay outcomes would differ across a range of plausible scenarios; including adverse macroeconomic conditions, sector downturns and predecessor-driven tailwinds; and satisfy themselves that the resulting range is defensible. Where outcomes are primarily attributable to external circumstances rather than executive skill, the board should retain and exercise discretion to adjust awards accordingly.[10, 13]

Remuneration committees are encouraged to treat that discretion not as an exception to rigorous governance but as one of its central instruments. The argument advanced here is not that discretion should displace structured frameworks or operate as the unconstrained primary determinant of pay. It is that discretion should be actively exercised within whatever framework the board adopts, with the committee prepared to depart from formulaic outcomes where those outcomes do not reflect the quality of executive judgement, and to account for that departure with sufficient specificity to be credible to a well-informed long-term investor.

A formulaic plan that delivers outcomes mechanically; regardless of whether those outcomes reflect genuine executive contribution or contextual circumstance; is not evidence of robust governance; it is evidence of its abdication. Discretion should operate in both directions: committees should be as prepared to reduce or withhold awards where executive conduct, decisions or oversight failures have damaged the business, its stakeholders or its reputation as they are to recognise exceptional contribution where formulaic measures fail to capture it.

Where discretion is exercised, transparency is not optional; committees should disclose, with sufficient specificity, the factors considered, the counterfactual against which performance was assessed and the basis on which the discretionary outcome was determined. Opacity in the exercise of discretion does not protect the board; it undermines the legitimacy of the very judgement it is seeking to protect.

- What are the resources on which the CEO can draw? Is there a strong and well-functioning team, or will they largely be acting alone?
- How will company performance during and following their tenure benefit from pre-existing circumstances — inherited strategy, market position, or initiatives already in train?
- How do macroeconomic drivers, regulatory conditions and sector dynamics benefit or constrain performance in ways outside the executive's control?
- How might these dynamics change during their tenure for reasons unrelated to their decisions?
- Where discretion is proposed, can the committee articulate a specific, evidence-based account of the factors that justify departure from the formulaic result — one that a well-informed long-term investor would regard as credible?

Acknowledgement of known unknowns

Evidence is clear that cognitive biases lead boards to over-emphasise the causal role played by visible individuals and to underweight structural, systemic and external factors, even when those factors are more significant.[1, 11] Caution is therefore required in assessing what causes strong or weak performance, particularly when attempting to predict individual contribution in advance.

- What evidence exists to support the case that one individual can drive performance, good or bad, in comparable circumstances? Is that evidence robust or anecdotal, and is it consistent across varying business conditions?
- How do the remuneration arrangements play out across a range of scenarios? If external factors cause a downturn and threshold performance targets become unattainable, what approach to pay would still support the retention of capable executives?
- Is it preferable to design simpler structures and retain the ability to exercise informed discretion after the fact, rather than commit to formulaic outcomes in advance?

The individual

A substantial body of research demonstrates that appropriate recruits to senior executive positions are, by definition, already intrinsically motivated.[7 8 18] Boards are encouraged to communicate openly with executives about the need to maintain appropriate pay relativities throughout the organisation, and to subject market comparisons to rigorous scrutiny before accepting them as binding constraints on what must be paid to secure any individual's commitment. All-market comparisons risk being inflated by advisers with vested interests in higher pay.

- What will secure the commitment of this particular individual? What are their motivations, personal circumstances or life-stage factors that may affect how they value immediate cash relative to deferred or equity-based awards?
- Do perquisites or non-financial elements of the employment relationship; autonomy, public profile, institutional standing; provide meaningful alternatives to pay escalation?

Social licence as a governance input

Remuneration committees should formally consider the external legitimacy costs of proposed pay outcomes. This means asking not only whether a pay structure is technically defensible, but whether it would remain so in conditions of public controversy, regulatory scrutiny, employee dissatisfaction or customer backlash.[7]

The concept of social licence is not new to corporate governance, but its practical salience to remuneration has sharpened considerably. Research by Balogh, Wright and Zein demonstrates that stakeholder outrage functions as an independent constraint on executive pay, one that operates alongside, and sometimes more powerfully than, formal governance mechanisms such as shareholder votes.[7] Their findings suggest that boards which fail to anticipate legitimacy costs expose the company to reputational damage, political intervention and regulatory tightening that can prove more costly than the pay award itself.

The cases discussed in this paper illustrate the dynamic. At BP, executive pay attracted sustained criticism not because the quantum was unusual by FTSE 100 standards, but because it coincided with a cost-of-living crisis in which the company's sector was seen to be profiting from the circumstances causing public hardship.[29 30] At Thames Water, retention awards for senior management became a focal point for broader public dissatisfaction with the company's environmental record, financial fragility and service failures, turning what might otherwise have been a routine governance matter into a politically charged controversy.[31 32] In both cases, the reputational and operational consequences extended well beyond the direct cost of the awards themselves.

Boards should therefore treat social licence not as an afterthought or a communications risk to be managed, but as a substantive governance input. This requires remuneration committees to consider, as part of their deliberations, how proposed pay outcomes would be perceived by employees at different levels of the organisation, by customers, by regulators and by the public; particularly in scenarios where the company is underperforming, restructuring, making redundancies or requesting price increases. The objective is not to set pay by reference to external opinion, but to ensure that the board has weighed the full range of costs, including legitimacy costs, before committing to a remuneration outcome.

- Has the committee considered how the proposed remuneration outcome would read alongside the company's wider reporting; on workforce investment, pricing decisions, restructuring or redundancy programmes; and whether the two narratives are mutually reinforcing or contradictory?
- Has the board modelled the proposed pay structure against a range of plausible adverse scenarios; a profit warning, an environmental or safety incident, significant redundancies, a contested price increase; and satisfied itself that the remuneration outcome would remain defensible in each case?
- Where a pay outcome attracts political, regulatory or public scrutiny, the reputational and operational costs are borne by the company and its shareholders rather than by the executive or the remuneration adviser. Has the committee weighed this asymmetry of consequence as part of its deliberations?
- Does the ratio between CEO remuneration and that of the median employee; and between the CEO and the next tier of executives; reflect a deliberate judgement about organisational culture and leadership structure, or has it emerged incrementally through successive benchmarking rounds without periodic reassessment?

Alignment with shareholders

All else being equal, it is preferable for executives to hold shares in the company over a reasonable period. Long-term ownership can reinforce commitment and encourage decisions with durable consequences. However, the evidence from behavioural economics indicates that alignment through equity is more complex than conventional incentive design assumes.[26]

- How material is the required shareholding likely to be relative to the executive's overall financial position? At what point does equity exposure amount to genuine shared risk, rather than a marginal addition to an already substantial base of wealth?

- How do features such as loss aversion and mental accounting operate differently for share grants versus shares purchased with personal funds, and does this affect the intended alignment?

- What are the systemic effects of pay practices? Does benchmarking at a given percentile; and the ratcheting that results; actually deliver the competitive advantage it is assumed to provide?

Restraint on quantum

The ratchet dynamic described in this paper is well documented and remains active. Boards should treat peer-group benchmarking data with scepticism, recognise that aspirational peer selection inflates reference points, and accept that paying at or above the median is a collective practice that guarantees escalation.[21] [23] With median FTSE 100 CEO pay now at £4.58 million and the ratio to the median UK worker at 122:1, the reputational and social costs of further escalation should weigh explicitly in board deliberations.[2]

- Which skills are genuinely necessary for this role at this time, and which requirements are merely convention? Is the recruitment process truly competitive, and what unconventional talent pools might provide the competitive tension needed to test market assumptions?

- Are any unwarranted assumptions being made about what effective leadership looks like, assumptions that may be narrowing the field and artificially sustaining pay expectations?


Navigating the advisory landscape

Boards and remuneration committees should approach the external advisory ecosystem with the same critical scrutiny they are encouraged to apply to incentive design. The fact that a plan structure attracts proxy advisor approval, or that a pay quantum reflects consultant peer group data, does not constitute evidence that either is appropriate to the company's circumstances. Approval and appropriateness are not the same judgement.

Wholesale resistance to the advisory ecosystem is neither practical nor appropriate. Proxy advisory firms perform a legitimate aggregating function, and their recommendations serve an important protective role for minority shareholders whose interests might otherwise receive insufficient weight in contested votes. The concern advanced in this paper is not with that function but with the degree to which anticipatory conformity to adviser frameworks displaces the informed board judgement that remuneration governance requires.

The more productive response lies in constructive engagement: with shareholders, to articulate and defend remuneration structures that depart from convention on principled grounds; and, where appropriate, with proxy advisors directly, to provide the company-specific context that generalised frameworks may not readily accommodate.

Boards that identify systematic features of proxy advisor guidance that constrain contextually appropriate remuneration design should consider communicating that experience to regulators through structured and reasoned channels; with care that such engagement advances the integrity of the governance framework rather than the commercial interests of any single company or sector, avoiding the policy capture risks that arise where regulatory influence serves narrow rather than systemic ends. Such engagement has contributed to meaningful regulatory scrutiny: the European Union’s (EU) Shareholder Rights Directive II introduced transparency obligations requiring proxy advisors to disclose their methodologies, conflicts of interest and the basis for their voting recommendations, provisions transposed into UK law through the Proxy Advisors (Shareholders' Rights) Regulations 2019.[41] [42]

Simplicity over complexity

Evidence consistently shows that additional layers of incentive complexity do not improve the relationship between effort and reward; they widen the scope for unintended outcomes and make it harder for shareholders to assess whether pay reflects performance.[14] [9] Boards should prefer fewer, simpler pay elements and be prepared to explain why each component exists and what it is expected to achieve.

An evidential standard for objectives

If the critique of quantification is accepted, the practical question is not whether qualitative objectives can be included in incentive frameworks, but what standard of rigour should apply when they are. Regnan's view is that the standard is evidential rather than numerical: for every performance condition; whether expressed quantitatively or qualitatively; the expectation should be clearly articulated in advance, the evidence of achievement independently assessable, the executive's contribution identifiable, and the reasoning that connects evidence to outcome disclosed with sufficient transparency that a long-term investor can form a view on its credibility.[33 34]

In practice, this requires remuneration committees to adopt an explicit evidential framework for qualitative conditions. Prospective specificity, identified evidence, independent assessment and disclosed reasoning become the disciplines that substitute for formulaic scoring, and they are, in many respects, more demanding than simple numerical verification.

Remuneration committees might therefore ask:

- Has each qualitative objective been defined prospectively with sufficient specificity that a reasonable observer could distinguish between achievement and non-achievement, without retrofitting criteria at the point of assessment?
- What forms of evidence will the committee rely upon, and have these been identified in advance, with an appropriate mix of internal and independent perspectives rather than a primary reliance on the executive's own account of progress?
- Is the committee prepared to disclose its reasoning — including the evidence considered, the judgement reached and the link drawn between the two — with enough transparency that a long-term investor could form a view on the credibility and proportionality of the outcome?
- If a qualitative assessment were to be challenged by a shareholder, proxy adviser or the media, could the committee defend it on evidential grounds, or would it be reliant on assertions of good faith and procedural compliance?
- Has the committee satisfied itself that its own composition, expertise and access to information are adequate to the task of assessing qualitative performance with the rigour that long-term investors would expect?

This evidential approach does not make qualitative assessment easy; it makes it governable, and it ensures that the committee's role is one of active stewardship rather than mechanical administration. Where a board is unwilling to undertake this work, the appropriate conclusion is not to force every objective into a numerical proxy, but to acknowledge a gap between the governance task assumed and the committee's current capacity to discharge it.[33 34 35]

Environmental and social metrics: substance over symbolism

Where boards choose to incorporate environmental or social targets in remuneration, these should be few in number, material to the business, objectively assessable and connected to decisions that genuinely require executive judgement. They should not reward procedural compliance or activities the company would be expected to undertake in any event. The strong preference should be for situating such metrics within long-term equity awards rather than annual bonus structures, and boards should disclose with precision how targets were determined, what was achieved and why the outcome warranted reward.[33 35]

Regnan recognises, however, that the question is not only whether environmental and social metrics are well designed in isolation, but whether the remuneration framework as a whole reflects the organisation's exposure to sustainability-related risks and opportunities that are material to its long-term productive capacity. Where sustainability considerations are structurally embedded in the operating environment of the business; affecting the reliability of supply chains, the availability and quality of human capital, the trajectory of input costs, the viability of physical assets or the terms on which the company accesses markets and capital; they are not peripheral to performance. They are conditions of it.

Where sustainability considerations are genuinely strategic; representing material risks to organisational resilience or secular opportunities requiring active executive leadership; there is a defensible case for their integration into remuneration design. The discipline Regnan applies is the same as for any other performance condition: the target should be specific to the business, the outcome independently verifiable, the executive's contribution identifiable, and the connection to long-term value creation demonstrable.

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Absent these conditions, the inclusion of sustainability metrics risks adding cost, complexity and the appearance of responsible governance without improving executive accountability or outcomes.[33 34 35]

- Is the sustainability issue in question genuinely material to the business model; affecting cost, revenue, asset viability or market access; or is it peripheral to the company's core operations?
- Can the target be defined with sufficient precision to be independently verifiable, and is the executive's specific contribution to achieving it identifiable and distinguishable from the work of specialist teams or external advisers?
- Is the metric placed in a long-term equity structure that reflects the time horizon over which the sustainability outcome will materialise, rather than an annual bonus structure calibrated to short-term results?
- What would the pay outcome be if the target is met procedurally but without substantive improvement; for example, a climate disclosure produced but not followed by operational change? Has the board satisfied itself that the metric cannot be gamed in this way?
- Has the board disclosed, with sufficient specificity, how the target was set, how achievement was assessed and why the outcome warranted the award? Would a long-term investor find that explanation credible and sufficient?

A wider view of the labour market

Boards should challenge the assumption that the pool of qualified candidates for senior roles is as narrow as convention implies. The persistent lack of diversity at executive level suggests artificial constraints on recruitment rather than genuine scarcity. Broadening the field; by reconsidering requirements around sector-specific experience, international background and traditional career paths; would increase competitive tension and weaken the bargaining dynamics that sustain inflationary pay.[27]

Early and open engagement with shareholders

Regnan encourages companies to discuss remuneration arrangements with long-term investors well before a remuneration policy is put to a vote. Early engagement allows boards to test the rationale for their approach, understand investor expectations, and identify areas of potential concern before positions harden. Remuneration reports should demonstrate not only what was paid but why each element was chosen, how it connects to strategy, and how the board has weighed the considerations set out in this paper.

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