

Paying For Advice: The Role of the Remuneration Consultant in U.K. Listed Companies

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* Reader in Corporate Financial Strategy at Cranfield School of Management. The financial support of the P.D. Leake Trust (a charity associated with the ICAEW) is gratefully acknowledged. The Centre for Business Performance manages all grant applications.

I would like to thank Peter Brown, Martin Conyon, Brian Main, John Smith, Randall S. Thomas, Fred Tung, Cliff Weight, and the participants at the British Accounting Association Conference 2008, the EIASM 5th Workshop on Corporate Governance, and the Vanderbilt Law Review Symposium on Executive Compensation for their helpful comments during the preparation of this Article.

I. INTRODUCTION

Consultants have an important role in advising remuneration committees on the determination of executive compensation¹ in listed companies. Their work encompasses supplying data on pay in comparator companies, advice on the choice and design of remuneration schemes, modeling the implications of the suggested schemes, advice on taxation, preparation of documentation, implementation of the selected schemes, and liaison with institutional shareholders. They are acknowledged experts in their field.

There is, however, a catch. It has been suggested, both by ex-consultants and by regulators, that consultants have conflicts of interest which can lead to biases and result in lax structures or excessive levels of executive pay.² Despite this widely held view, academic research is equivocal.³

Although concerns over the use of compensation consultants date back two decades, and although several studies of executive remuneration have considered at least some aspect of the work of the

1. In this Article, the U.K. term “remuneration” and the U.S. term “compensation” are used interchangeably with the more generic “pay.”

2. For books written by individuals who had previously worked as compensation consultants, see GRAEF S. CRYSTAL, *IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES* (1991) (alluding to the author’s experience as a consultant); A.P. WILLIAMS, *JUST REWARD? THE TRUTH ABOUT TOP EXECUTIVE PAY* (1994) (same). For regulators’ views from three major jurisdictions, see STAFF OF H. COMM. ON OVERSIGHT AND GOV’T REFORM, 110TH CONG., *EXECUTIVE PAY: CONFLICTS OF INTEREST AMONG COMPENSATION CONSULTANTS 3* (Comm. Print 2007) (prepared for Chairman Henry A. Waxman) [hereinafter WAXMAN REPORT] (finding major conflicts of interest in setting executive compensation due to management’s influence over the process); TREASURY COMMITTEE, *BANKING CRISIS: REFORMING CORPORATE GOVERNANCE AND PAY IN THE CITY, 2008–9*, H.C. 519 [hereinafter U.K. TREASURY COMMITTEE REPORT] (exploring compensation in the City of London and describing the interaction between various actors in the private sector); David Wright, Deputy Dir., Gen. Internal Mkt. and Servs., Closing Remarks at the European Commission Services Roundtable on Directors’ Remuneration (Mar. 23, 2009), available at http://ec.europa.eu/internal_market/company/docs/directors-remun/roundtable_wright_en.pdf (summarizing contemporary issues of executive pay within the European Union).

3. For example, Martin J. Conyon, Simon I. Peck, and Graham V. Sadler found no conclusive evidence of conflicts of interest leading to excessive pay. Martin J. Conyon et al., *Compensation Consultants and Executive Pay: Evidence from the United States and the United Kingdom*, *ACAD. MGMT. PERSP.*, Feb. 2009, at 43, 43 (2009). Likewise, Brian Cadman, Mary Ellen Carter, and Stephen Hillegeist found no clear evidence that conflicts drove excessive pay levels for CEOs. Brian Cadman et al., *The Incentives of Compensation Consultants and CEO Pay*, *J. ACCT. & ECON.* 263, 263 (2010). Mixed results were reported in Kevin J. Murphy & Tatiana Sandino, *Executive Pay and “Independent” Compensation Consultants*, 49 *J. ACCT. & ECON.* 247, 247 (2010). They found that higher levels of pay were related to the potential conflict of interest, although, contrary to one of their hypotheses, consultants employed by the board were associated with higher levels of CEO pay than those employed by the management. A full review of the literature is included in Martin J. Conyon, *Executive Compensation Consultants and CEO Pay*, 64 *VAND. L. REV.* 399, 411–17 (2011).

consultant, until recently, very few articles had directly examined the impact compensation consultants have on executive pay. Regulatory developments have changed this. In the United Kingdom, the introduction of the Directors' Remuneration Report Regulations ("DRRR")⁴ has mandated disclosure of details of remuneration committee advisors since 2002. In the United States, the Securities and Exchange Commission introduced requirements for disclosure in the Compensation Discussion and Analysis ("CD&A") in 2006, including disclosure of the roles of consultants advising the compensation committee, their names, and the scope of their work. These data have stirred academic interest.

A number of recent papers have considered the activities of compensation consultants in the United Kingdom and the United States.⁵ This Article adds to that literature. It is one of very few studies to adopt a qualitative research approach to the work of the remuneration committee,⁶ and the first to focus on the work of the compensation consultant. Using data from interviews with protagonists in remuneration-setting for selected FTSE 350 companies,⁷ it addresses the questions of why consultants are used and what they do, and explores their perceived strengths and the limitations of their work. In doing so, this research supplements quantitative research, provides some background and context to other papers that are appearing in this field, and informs practice in an area which is increasingly contentious. In rich detail, this Article shows some of the attitudes behind the words companies use in their remuneration reports. It suggests that the use of compensation

4. Directors' Remuneration Report Regulations 2002, 2002, S.I. 2002/1986, art. 3, § 234B [hereinafter DRRR], available at <http://www.opsi.gov.uk/si/si2002/20021986.htm>.

5. See, e.g., Conyon, *supra* note 3, at 411–17, 426–27 (finding no conclusive evidence that conflicts of interest among consultants lead to higher executive pay); see also Martin J. Conyon et al., *New Perspectives on the Governance of Executive Compensation: An Examination of the Role and Effect of Compensation Consultants*, 15 J. MGMT. & GOVERNANCE 29, 29–58 (2011) (finding some evidence that where consulting firms supply other services to a corporation, CEO pay is higher).

6. For qualitative studies of executive compensation practices, see Ruth Bender, *How Executive Directors' Remuneration Is Determined in Two FTSE 350 Utilities*, 11 CORP. GOVERNANCE 206, 206 (2003); Martin J. Conyon et al., *The Structure of Executive Compensation Contracts: UK Evidence*, 33 LONG RANGE PLANNING 478, 478 (2000); Brian G. M. Main et al., *The Remuneration Committee and Strategic Human Resource Management*, 16 CORP. GOVERNANCE 225, 225 (2008); Stuart Ogden & Robert Watson, *Executive Pay and the Search for Legitimacy: An Investigation into How UK Remuneration Committees Use Corporate Performance Comparisons in Long-Term Incentive Pay Decisions*, 61 HUM. RELATIONS 711, 711 (2008); Stephen Perkins & Chris Hendry, *Ordering Top Pay: Interpreting the Signals*, 42 J. MGMT. STUD. 1443, 1443 (2005).

7. The FTSE 350 are the 350 largest companies on the London Stock Exchange, by market capitalization.

consultants can be best explained using theories of legitimacy: by taking outside advice, the compensation committee legitimizes its decisions in the controversial area of executive pay.

The structure of this Article is as follows. Part II briefly reviews relevant research. This is followed in Part III by an explanation of the research approach adopted for this work. The findings of the work are set out in Part IV and discussed in Part V. The Article then concludes.

II. REVIEW OF PRIOR RESEARCH

Prior research has acknowledged the important role consultants play in the remuneration-setting processes of large companies.⁸ Three main themes underlie much of the work in this area:

1. How consultants are used as experts. They provide data on pay in peer companies so that committees can choose where to set compensation levels. They also provide advice on structuring remuneration plans.

2. Whether, or how, the level and structure of executive pay differ between companies that take advice from compensation consultants and those that do not.

3. How consultants are perceived to confer legitimacy on remuneration packages by providing external input into the committees' decisions.

A. The Consultant as an Expert

1. Providing "Market" Data

There is no obvious answer to the question, how much should we pay the executives? By custom and practice, pay is set in line with a self-defined "market," which is determined by reference to a group of peer companies.⁹ Although for some businesses the human resources ("HR") personnel collect these comparator data, in most larger companies this work is done by, or with the aid of, remuneration consultants. The consultants maintain detailed databases of the pay of their own clients, as well as surveying compensation details publicly available on other listed companies. These data are more

8. Conyon et al., *supra* note 5, at 30.

9. Perkins & Hendry, *supra* note 6, at 1457; Ruth Bender, *The Platonic Remuneration Committee* 14 (Paper Presented at the 5th International Conference on Corporate Governance, Birmingham, England, 2007), available at <http://ssrn.com/abstract=1647005>.

comprehensive than those available to the HR personnel, and often more up-to-date. Specifically, remuneration consultants provide both generic pay surveys that cover, for example, all FTSE 350 CEOs, and surveys that are tailored to the needs of their clients, for example, relating to a specific role or dealing with a subsector of a particular industry¹⁰

Several authors have commented upon the use of these pay surveys, rarely favorably. Two criticisms are common: the impact of the choice of peers (also known as comparators) and the impact of surveys themselves on the general level of executive compensation. As regards the comparators used in the surveys, Luis Gomez-Mejia and Robert Wiseman referred to “a cottage industry of consultants that specializes in conducting surveys to measure a wide range of CEO compensation statistics.”¹¹ They suggested that, although this is a widespread practice, not much is known about the use of such “competitive market going rates.” A decade later, the problem remains. It has been said that the choice of appropriate comparators is perhaps the most difficult problem that confronts the remuneration committee.¹² Nonetheless, custom and practice dictate that compensation be set in relation to a peer group. Accordingly, committees need these data and rely on the advice of compensation consultants, who have great discretion in selecting and framing the issues and presenting the data to the committee.¹³

Regardless of the validity of the comparators, the consultants’ surveys themselves are widely seen as a cause of ever-increasing levels of executive pay.¹⁴ Although this is unsatisfactory, no other way

10. RUTH BENDER, THE DETERMINATION OF DIRECTORS’ REMUNERATION IN UK LISTED COMPANIES, ICAEW BRIEFING 4–6 (2004), available at <http://www.icaew.co.uk/index.cfm?route=117888>; Main et al., *supra* note 6, at 226.

11. Luis R. Gomez-Mejia & Robert M. Wiseman, *Reframing Executive Compensation: An Assessment and Outlook*, 23 J. MGMT. 291, 327 (1997).

12. Ogden & Watson, *supra* note 6, at 716.

13. See, e.g., LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 38 (2004) (detailing compensation consultants’ broad discretion in performing their tasks); Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?* 57 VAND. L. REV. 1171, 1193 (2004) (noting that consultants “supply the justifications needed to rationalize” a corporate compensation decision).

14. See, e.g., Arch Patton, *Those Million-Dollar-a-Year Executives*, in EXECUTIVE COMPENSATION, A STRATEGIC GUIDE FOR THE 1990S 43 (Fred Foulkes ed., 1991) (suggesting that the surveys were the main source of executive pay inflation in the United States, with companies choosing to pay at or above the average of the surveyed range). Similar findings were recorded in U.K. studies. See, e.g., Conyon et al., *supra* note 6, at 487 (noting the potential of surveys to “ratchet-up” executive pay); Mahmoud Ezzamel & Robert Watson, *Market Comparison Earnings and the Bidding-Up of Executive Cash Compensation: Evidence from the United Kingdom*, 41 ACAD. MGMT. J. 221, 223 (1998) (highlighting that the availability of comparable wage surveys

has been found to determine executive pay, and the use of consultants to advise on peer groups and gather supporting data is ubiquitous.¹⁵

2. Advising on Scheme Design

Remuneration committee members, all of whom are non-executive directors¹⁶ of the company, are not expected to be experts in the minutiae of scheme design, and they need independent advice in order to carry out their tasks.¹⁷ This advice comes from the compensation consultants, who provide an expert knowledge base over and above that which the company possesses internally.¹⁸ This knowledge base is evidenced by the way in which consultants advise on plan design, displaying their technical knowledge of the different types of plan that are possible, their market knowledge of what is acceptable, and their experience with successful implementation.

The consultants do more than reflect the body of knowledge surrounding executive pay: they also help to create it. In an example of normative isomorphism, the practices they follow are promulgated around the various companies they advise, until often they become seen as “best” practice.¹⁹ As Kyungmook Lee and Johannes Pennings

reinforces the influence of the external labor market); Perkins & Hendry, *supra* note 6, at 1445 (reiterating that a perverse outcome of proliferation of salary surveys was to ratchet-up salaries overall).

15. See, e.g., BENDER, *supra* note 10, at 14; Conyon et al., *supra* note 3, at 45 (emphasizing the problems associated with using surveys in setting executive pay); Rezaul Kabir & Marizah Minhat, Multiple Compensation Consultants and CEO Pay (May 31, 2010) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1646926 (noting the prevalence of compensation consultants in setting CEO pay).

16. Throughout this Article, the U.K. term “non-executive” or “non-executive director” (“NED”) is used. This corresponds to the U.S. terminology “director.”

17. See Main et al., *supra* note 6, at 230 (noting that the remuneration committee is seen as a “generalist committee” whose members “invariably made reference to the part consultants play in the process”); Bertrand Malsch et al., *Risk, Blame and Allegiance in Compensation Committees: A Cultural Theory Perspective* 20–21 (Université Laval, Québec Working Paper, 2009) (“[Remuneration committee] members’ competencies are not perceived as being sufficient for committees to carry out their duties in an effective manner; outside parties (especially consultants) . . . are seen as playing a key role in this respect.”).

18. See, e.g., Conyon et al., *supra* note 5, at 33 (noting that compensation consultants are “clearly external” and possess “skills, accreditation and experience from repeated interactions with those at the upper echelons of companies”).

19. See, e.g., SYDNEY FINKELSTEIN & DONALD HAMBRICK, STRATEGIC LEADERSHIP: TOP EXECUTIVES AND THEIR EFFECTS ON ORGANIZATIONS 275–79 (1996); Paul DiMaggio & Walter Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147, 149–50 (1983) (describing the application of “isomorphism” to organizational behavior); Jonathan Trevor, *Exploring the Strategic Potential of Pay: Are We Expecting Too Much?* 6 (Judge Bus. Sch., Univ. of Cambridge, Working Paper No. 02/2009, 2009) (noting that the adoption of perceived winning strategies as “best practices”

note in relation to the broader discipline of management consultancy, “As external consultants or internal experts, professionals may play an important role in trend setting and legitimizing new templates.”²⁰ This is illustrated specifically for compensation consultants: “[Consultants] keep promoting what they think is the industry norm, and we ask, ‘Is it the industry norm that you have suggested?’ And then they promote to another company and then to a third company . . . so it’s become an industry norm.”²¹

3. Impression Management

It is not sufficient for consultants to be experts; they must *appear* to be experts. A thread of papers discusses consultancy as an exercise in impression management.²² The works occupying this thread argue that the deliverables from consultancy are intangible, making them difficult for the client to assess and to compare with other providers. Hence, proxies are used to assess the value of what is being bought and what has been received. Such signals include the consultants’ reputation and client base, the words they use to describe their expertise, and their appearance, literature, and presentations. These are all seen as indicators of the quality of the advice, and ultimately consultants use them to signal that their clients are adopting best practice.²³

within an industry “is an additional institutional mechanism through which isomorphism occurs”).

20. Kyungmook Lee & Johannes Pennings, *Mimicry and the Market: Adoption of a New Organizational Form*, 45 ACAD. MGMT. J. 144, 149 (2002).

21. Conyon et al., *supra* note 6, at 488.

22. *See, e.g.*, TIMOTHY CLARK, MANAGING CONSULTANTS: CONSULTANCY AS THE MANAGEMENT OF IMPRESSIONS 62 (1995) (“[I]n order to create the impression of a high quality service . . . consultants must focus their efforts on the active management of the interaction process with clients.”); Matthias Kipping, *Trapped in Their Wave: The Evolution of Management Consultancies*, in CRITICAL CONSULTING: NEW PERSPECTIVES ON THE MANAGEMENT ADVICE INDUSTRY 28, 40 (Timothy Clark & Robin Fincham eds., 2002) (“Consultancies therefore build their credibility and reputation indirectly through the use of a wide variety of symbols.”); Timothy Clark & Graeme Salaman, *Creating the “Right” Impression: Towards a Dramaturgy of Management Consultancy*, SERV. INDUS. J., Jan. 1998, at 18, 19 (“[T]he art of impression management . . . is at the core of consultancy work.”).

23. *See, e.g.*, CLARK, *supra* note 22, at 28 (“A number of studies have reported that reputation of a consultancy and its consultants is the more important criterion identified by clients to select between consultancies.”); Kipping, *supra* note 22, at 39–40 (“[C]ompanies cannot hire just any consultancy. Rather, the one selected has to be perceived by others as being up-to-date, modern, etc.”). Anecdotal evidence suggests that reputation is a strong factor in helping companies choose between consultants. Robin Fincham & Mark Evans, *The Consultants’ Offensive: Reengineering—From Fad to Technique*, 14 NEW TECH. WORK & EMP. 32, 37 (1999), discuss how consultants use glossy pamphlets with superb graphics as a proxy to demonstrate the quality of their underlying product. Consultants’ reputation is enhanced by displaying an

B. Influence on the Level and Structure of Executive Pay

In recent years, several researchers have examined the influence of remuneration consultants on the level and structure of executive pay, in particular considering whether the use of consultants is reflected in the nature of the schemes adopted.²⁴ Although there are differences in approach, many results of these studies are similar. It is well known that company size is correlated to levels of executive pay and, as would be expected, it is mostly the larger, more complex companies that employ consultants.²⁵ However, even allowing for size, the use of compensation consultants does correlate to higher pay levels for the CEO.²⁶ Using consultants also has an implication for plan design. Research has shown that companies using consultants tend to use more equity-based incentives in their pay packages than do companies that do not use such advice.²⁷

These results could be explained in two different ways. On the one hand, it may be that companies seeking to use equity-based plans

extensive blue chip client base and network, which is a symbol of quality. *See, e.g.*, Timothy Clark & Graeme Salaman, *Telling Tales: Management Gurus' Narratives and the Construction of Managerial Identity*, 35 J. MGMT. STUD. 137, 151 (1998) ("Gurus' stories in part claim authority by referencing other famous, successful, senior clients . . ."); Karen Legge, *On Knowledge, Business Consultants and the Selling of Total Quality Management*, in CRITICAL CONSULTING: NEW PERSPECTIVES ON THE MANAGEMENT ADVICE INDUSTRY, *supra* note 22, at 77–78 (analyzing the reputation-building rhetoric in the claims present in a British management consultancy firm's "glossy brochure").

24. *See, e.g.*, sources cited *supra* note 3. *See also* Leena Kostander, *How Consultants Increase Executive Remuneration: A Process Approach* (July 2010) (unpublished manuscript) (on file with the author) (providing interview-based evidence from Finland).

25. *See, e.g.*, Conyon et al., *supra* note 5, at 46–49 & tbl.4 (presenting evidence that firm size positively correlates with seeking external compensation advice); Georgios Voulgaris et al., *Compensation Consultants and CEO Pay: UK Evidence*, 18 CORP. GOVERNANCE 511, 515 (2010) (presenting evidence that firm size correlates with compensation). Cadman, Carter, and Hillegeist found that seventy-three percent of Russell 3000 firms retain a compensation consultant, compared to eighty-six percent of their sample of S&P 1500 firms. Cadman et al., *supra* note 3, at 276.

26. Chris Armstrong et al., *Economic Characteristics, Corporate Governance, and the Influence of Compensation Consultants on Executive Pay Levels* 20–21 (Rock Ctr. for Corp. Governance, Working Paper No. 15, 2008), available at <http://ssrn.com/abstract=1145548> (finding a positive correlation even when economic determinants, including company size, were statistically controlled); Murphy & Sandino, *supra* note 3, at 254–55 (same). Conyon, Peck and Sadler suggest that one reason for these higher pay levels is that the greater proportion of equity-based pay in consultant-designed packages means that the executives need extra compensation for their additional risk. Conyon et al., *supra* note 3, at 52.

27. *See, e.g.*, Conyon et al., *supra* note 3, at 52 (providing U.K. and U.S. evidence); Voulgaris et al., *supra* note 25, at 512 (providing U.K. evidence). And, in a unique context, a study of practices in Finnish state-owned enterprises—where executive pay is regulated—suggests that consultancies exploit loopholes by designing complex schemes that favor management. Kostander, *supra* note 24, at 33–34.

realize that this is a complex area and thus decide to employ consultants to advise on and implement these plans. Alternatively, it could be because the consultants' default setting is to use complex, equity-based plans. If the latter is true, this could be a result of consultants' desire to demonstrate that they are adding value (doing something that their clients could not do unaided), or it could arise due to a potential conflict of interest between their work for the company (represented by its compensation committee) and their relationship with its CEO.

Much is written about the potential for consultants to experience such a conflict of interest.²⁸ Kevin Murphy and Tatiana Sandino propose two underlying sources of conflict: a wish to retain the client in subsequent years and a desire to cross-sell their other services to the company.²⁹ This has affected the pronouncements of regulators on both sides of the Atlantic. A U.S. House of Representatives committee concluded that “[c]ompensation consultant conflicts of interest are pervasive,” and recommended that the consultant the board retained should not perform other work for the company.³⁰ Similarly, in the United Kingdom, the House of Commons Treasury Committee, examining the role of executive compensation practices in the financial crisis, suggested that there was an “incestuous relationship between consultants and the remuneration committees that they were advising.”³¹ Its final report concluded:

We have received a body of evidence linking remuneration consultants to the upward ratchet of pay of senior executives in the banking sector. We have also received evidence about potential conflicts of interest where the same consultancy is advising both the company management and the remuneration committee. Both these charges are serious enough to warrant a closer and more detailed examination of the role of remuneration consultants in the remuneration process.³²

Nonetheless, academic research on the impact of conflicts of interest has produced mixed results.³³

28. See, e.g., Murphy & Sandino, *supra* note 3, at 248 (discussing “repeat business” and “other services” conflicts); John Plender, *It Pays to Simplify Boardroom Compensation*, FIN. TIMES, Jan. 5, 2007, at 15 (labeling compensation consultants “an unregulated and conflicted bunch”).

29. Murphy & Sandino, *supra* note 3, at 248.

30. WAXMAN REPORT, *supra* note 2.

31. *Banking Crisis: Hearing Before the House of Commons Treasury Committee*, at Q575 (2008) (to be published as H.C. 1167–iv), available at <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/uc1167-iv/uc116702.htm>.

32. U.K. TREASURY COMMITTEE REPORT, *supra* note 2, para. 82.

33. See *supra* note 3 and accompanying text. A few studies have found such evidence. For example, the Waxman Report found a correlation between the extent of a consultant's conflict of interest and the level of CEO pay. WAXMAN REPORT, *supra* note 2, at 6–7. A Finnish qualitative study by Kostander reported consultants' bias in favor of management. Kostander, *supra* note

*C. Using Consultants to Confer Legitimacy on the
Committee's Decisions*

The non-executives on a remuneration committee are in a vulnerable position, having to work in a collegiate manner with the executives in a unitary board structure, but also having a responsibility for monitoring governance and determining the executives' pay.³⁴ Many observers accuse these directors of being too close to the executives, and thus, consciously or unconsciously, biased in favor of high awards.³⁵ Murphy suggests that this is an unconscious bias, but that “[f]aced with a range of market data on competitive pay levels, committees tend to error on the high side.”³⁶

One important role for the consultant is as an independent party to the pay process, providing impartial advice and thus conferring legitimacy on the committee's decisions.³⁷ This can also be a form of risk management on behalf of the committee. Given that there is no single right answer to most questions on executive compensation, the committee and the board use advice from consultants to justify any decisions that are later challenged.

24, at 31. A U.K. study also found evidence that the consultants are concerned with the risk of losing business. Kabir & Minhat, *supra* note 15, at 17–18. Nonetheless, the bulk of the extant research is equivocal, either showing no evidence of conflict of interest or only slight correlations. For example, neither Armstrong et al., *supra* note 26, at 6, nor Cadman et al., *supra* note 3, at 272, found support for claims that CEO pay is higher in companies advised by multi-business consultancies, and Conyon et al., *supra* note 3, reported no evidence that a potential conflict of interest affected contract design. However, Murphy and Sandino, *supra* note 3, at 260, in an analysis for the United States and Canada, had mixed results. Conyon reviews this literature, setting out details of the samples and methodologies in these studies, and concludes that there is no clear-cut evidence of the effect of a conflict of interest. Conyon, *supra* note 3, at 411–17, 426–27. Thus far, the lack of academic evidence of the detrimental effects of conflict of interest has not affected regulatory pronouncements on the subject.

34. Laura F. Spira & Ruth Bender, *Compare and Contrast: Perspectives on Board Committees*, 12 CORP. GOVERNANCE 489, 490–96 (2004).

35. Brian G. M. Main et al., *The CEO, the Board of Directors and Executive Compensation: Economic and Psychological Perspectives*, 4 IND. & CORP. CHANGE 293, 326–28 (1995); Brian G. M. Main & James Johnston, *Remuneration Committees and Corporate Governance*, 23 ACC. & BUS. RES. 351, 534–36 (1993); Kevin J. Murphy, *Executive Compensation*, in 3 HANDBOOK OF LABOR ECONOMICS 2485, 2517–18 (Orley Ashenfelter & David Card eds., 1999).

36. Murphy, *supra* note 35, at 2518.

37. See, e.g., Mahmoud Ezzamel & Robert Watson, *Pay Comparability Across and Within UK Boards: An Empirical Analysis of the Cash Pay Awards to CEOs and Other Board Members*, 39 J. MGMT. STUD. 207, 210 (2002) (summarizing how compensation committees must “strike a balance” between providing financial incentives to executives to improve firm performance while also maintaining legitimacy through using external benchmarks to establish pay); Main et al., *supra* note 6, at 234 (discussing the desire to attain perceived legitimacy in the remuneration process); Ogden & Watson, *supra* note 6, at 714 (discussing the importance of issues of legitimacy in the analysis of executive remuneration).

A useful illustration of how consultants are used to legitimize pay decisions is an examination of a sample of U.S. compensation committee reports to determine how they justified their compensation choices to their shareholders.³⁸ The use of consultants was frequently the mechanism adopted to obtain external validation. Harry Barkema and Luis Gomez-Mejia referred to this phenomenon as “judgments of the committee members, legitimized by the opinions of external consultants.”³⁹ In many situations where a decision cannot be proved to be “right,” such legitimacy is valuable to boards, as it gives companies access to outside resources.⁴⁰

However, legitimacy is an intangible that can only be achieved if the consultants are perceived to be independent, and we have already seen that this independence can be challenged due to potential conflicts of interest. The governance commentator Robert Monks stated this somewhat pointedly:

A critical question of corporate legitimacy is whether CEOs set their own pay. “Best practice” has decreed an elaborate “ritual” through which the board of directors creates a Compensation Committee consisting entirely of “independent” directors. . . . Likewise, when the independent members of the Compensation Committee appoint an independent executive compensation consultant to assist them, one need suspend disbelief as to the appetite of personal service organizations to bring unwelcome advice to their clients.⁴¹

Authors familiar with the workings of the industry have confirmed the difficulties this conflict causes.⁴² Not surprisingly, those currently working as compensation consultants dispute the existence of such difficulties. Evidence the consulting firms gave to the House of Representatives Committee⁴³ emphasized the firms’ independence:

38. James B. Wade et al., *Worth, Words, and the Justification of Executive Pay*, 18 J. ORG. BEHAV. 641, 641–44 (1997) (concluding that companies with concentrated and active outside ownership were more likely to justify their compensation practices by citing the role of compensation consultants, as were those paying their CEOs large base salaries).

39. Harry G. Barkema & Luis R. Gomez-Mejia, *Managerial Compensation and Firm Performance: A General Research Framework*, 41 ACAD. MGMT. J. 135, 141 (1998).

40. Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571, 574 (1995).

41. Robert A.G. Monks, *Executive and Director Compensation—1984 REDUX*, 6 CORP. GOVERNANCE 135, 137 (1998).

42. See, for example, two authors who had previously worked as compensation consultants, Marc Hodak, *Alignment Exposed: How CEOs are Paid, and What Their Shareholders Get for It*, 16 J. APPLIED CORP. FIN., Spring 2004, at 111, 112 (suggesting that the retention of consultants depends on whether the scheme they devised has paid out, regardless of performance), and Vadim Liberman, *It’s Not Our Fault—Usually*, ACROSS THE BOARD, Mar.–Apr. 2003, at 51, 53 (quoting a CEO’s comment: “The basic goal of compensation consultants is to justify whatever it is the CEO wants to make.”).

43. WAXMAN REPORT, *supra* note 2.

Representatives of two of the consultancies, Towers Perrin and Hewitt Associates, testified that they have clear internal divisions separating employees who deal with compensation committees from those who work with executives and management. The two firms are “diversified” companies, offering both executive pay advisement and other services such as human resources management.⁴⁴

Both researchers and the press also report the view that U.S. consulting firms are improving their practices by segregating those who provide advice on executive compensation from those working on other assignments for a company.⁴⁵

However, recent developments in the consulting industry reflect the firms’ growing awareness that they need to tackle this perceived conflict of interest more directly. In February 2010, Hewitt Associates, one of the larger firms, announced that it was spinning off its executive compensation consulting activities. The accompanying press release commented that the decision “creates opportunities for us to expand our relationships with those clients that may have felt restricted from engaging Hewitt for broader consulting and outsourcing work because we were the executive compensation consultant to their board.”⁴⁶ In a similar fashion, Ira Kay, a high-profile compensation consultant at Watson Wyatt, left that firm in January 2010 to run his own boutique consultancy specializing in executive compensation.⁴⁷

In the United Kingdom, the use of separate consultants to advise the remuneration committee has become more common practice

44. L. Reed Walton, *Pay Consultant Concerns Debated*, RISKMETRICS GRP. BLOG (Dec. 7, 2007, 10:21 AM), <http://blog.riskmetrics.com/gov/2007/12/pay-consultant-concerns-debatedsubmitted-by-l-reed-walton-publications.html>.

45. Murphy and Sandino refer to interviews with senior consultants who stated that previously acceptable practices had changed, and their firms now had “Chinese Walls” between the different parts of their practices in order to prevent such conflicts. Murphy & Sandino, *supra* note 3, at 261. Attempts by U.S. consulting firms to improve these practices are also discussed by Julie Creswell, *Pressing for Independent Advice from Consultants*, N.Y. TIMES, Apr. 8, 2007, § 3, at 9, available at http://www.nytimes.com/2007/04/08/business/yourmoney/08consult.html?_r=1.

46. Rebecca Moore, *Hewitt Announces Spinoff of Comp Consulting Business*, PLANSPONSOR, Feb. 1, 2010, http://www.plansponsor.com/Hewitt_Announces_Spinoff_of_Comp_Consulting_Business.aspx.

47. One article reported Mr. Kay as saying that “he opened his own shop because the proposed SEC rule, federal bill and merger accord had cost him three of his 20 board assignments at companies where Watson Wyatt or Towers Perrin provide pricier management services.” Joann S. Lublin, *More Boards Opting for Independent Pay Advisors*, WALL ST. J., Jan. 11, 2010, at B7, available at <http://online.wsj.com/article/SB10001424052748703535104574646823950331160.html>. Watson Wyatt and Towers Perrin merged in January 2010. In June 2010, Towers Watson issued a press release stating that it would continue to offer executive compensation services, but clients wishing to retain separate advisors were recommended to use Pay Governance LLC, the spin-off consultancy created by Mr. Kay and others. See Press Release, Towers Watson, *Towers Watson Aligns Executive Compensation Consulting Strategy with Evolving Range of Client Needs* (Apr. 30, 2010), <http://www.towerswatson.com/press/1753>.

since the implementation of the DRRR in 2002, which demands disclosure, *inter alia*, of the names of consultants advising the remuneration committee, the nature of their involvement, and whether or not the committee appointed the consultants. This may be one reason why the use of multiple consultants is more prevalent in the United Kingdom than the United States,⁴⁸ with one study suggesting that more than half of FTSE 350 companies use more than one consultant.⁴⁹

III. RESEARCH APPROACH

This research forms part of a study conducted in the United Kingdom on how executive directors' pay was determined in selected FTSE 350 companies. Previous work in this field has examined the policies adopted by companies and the sums awarded. This research differs from prior studies by focusing on *how* companies determine their executive compensation policies and packages, rather than examining the outcomes of their decisions. To do this, the study adopts a qualitative methodology.

The work was interview-based, with the interviewees primarily being CEOs, remuneration committee chairs and members, and HR professionals from twelve companies in all, together with five of the compensation consultants advising those companies.

The sample of companies was initially selected from the PricewaterhouseCoopers Corporate register, identifying FTSE 350 companies that appeared to be in compliance with all relevant aspects of the Combined Code, and which appeared to the author to present an interesting context for study.⁵⁰ Companies were contacted by telephone to seek their involvement in the project; companies one through six joined the study via this approach. This process of finding research participants proved to be slow, and companies seven through

48. See Conyon et al., *supra* note 3, at 47–49 (discussing U.K. disclosure regulations and the general prevalence of the use of executive pay consultants).

49. Kabir & Minhat, *supra* note 15, at 2–3.

50. Case companies where NEDs sat on several different boards were preferred, as it was considered that they would be able to comment about a wider range of practices in addition to the focal company. Also, utilities and financial services companies were favored, as representing two ends of the pay spectrum. Utilities in the United Kingdom have an interesting position relating to directors' remuneration—it was the high pay and option awards made to directors of the newly privatized utilities that led to the “fat cat” debate, which resulted in the Greenbury Report of 1995. DIRECTORS' REMUNERATION: REPORT OF A STUDY GROUP CHAIRED BY SIR RICHARD GREENBURY (1995) [hereinafter GREENBURY REPORT], available at <http://www.ecgi.org/codes/documents/greenbury.pdf>. Indeed, the Greenbury Report had a separate section (section 8) that discussed the criticism of pay in the privatized utilities.

ten were contacted through a network of remuneration professionals that one of the early interviewees identified. Interviews were conducted at companies eleven and twelve following a conference presentation by the author of papers setting out some of the research results. Of the companies, four were utility companies, three were from the financial services sector, and the remainder were from other industrial sectors; nine were in the FTSE 100 index, and the other three were in the FTSE 250.

Table 1 sets out some information about the interviewees from the twelve companies.

Table 1: Company Interviewees by Role

Co.	HR professional	Remuneration committee chairman	NED	CEO	Company secretary	Company chairman	Consultant	Total
1	2	1	1	1			1	6
2	1	1	1	1			1	5
3	1							1
4	1	1		1				3
5	1		1		1	1	1	5
6	2							2
7	1	1	2	1	1		1	7
8	1						1	2
9	1							1
10	1							1
11					1			1
12		1						1
Total	12	5	5	4	3	1	5	35

Additionally, five interviews were conducted with an institutional representative, head-hunters, a group of remuneration professionals, and a focus group brought together to discuss the results of the research.⁵¹ In all, the author conducted forty individual and group interviews between 2001 and 2003.⁵² The interviews, which lasted on average one hour, were taped and transcribed.

51. The use of such a focus group as a method of verification for qualitative research is recommended by MATTHEW B. MILES & A. MICHAEL HUBERMAN, *QUALITATIVE DATA ANALYSIS: AN EXPANDED SOURCEBOOK* 275–77 (2d ed. 1994).

52. The limitations of the study must be acknowledged. The work reflects a series of interviews conducted during 2001–2003. Since then, the regulatory framework in the United Kingdom has changed, which is likely to have led to changes in practice. Thus, were this

Remuneration committees were far more circumspect about making available their documentation than they were about arranging interviews.⁵³ Nevertheless, documentation, such as remuneration committee meeting minutes and consultants' reports, was reviewed for five of the companies. Apart from one very anodyne set of committee meeting minutes emailed to the author, these reviews were conducted on the companies' premises, often under the supervision of company personnel. No copying of the documents was permitted, and in one instance the company secretary reviewed the author's hand-written notes on completion of the exercise. Also examined were financial statements (which included the published remuneration reports) for all companies for the preceding, current, and immediately subsequent years.

The interview transcripts, notes, and company documents were analyzed using NVivo to manage the data. They were coded to reflect what was happening in the companies, and the theoretical perspectives that this reflected.

IV. FINDINGS⁵⁴

In this Part the findings from interviews concerning the role of the consultants in remuneration decisions are set against the summary of prior research and accented using narratives taken from the websites of some of the United Kingdom's main remuneration consultants.⁵⁵

research to be conducted today, some differences would be expected. However, in the process of preparing and reviewing this Article, during 2008 and 2009 drafts were discussed with two U.K. compensation consultants and one ex-consultant, to confirm the continued applicability of these findings.

53. Their explanation was that the documentation supporting their decisions included references to detailed information for individuals, which many were not comfortable with sharing.

54. This Part includes many quotations taken from interviews with executive compensation consultants and others, whose job titles are included in parentheses at the end of the quotes, conducted as part of the author's original research for this Article. The original source material, including interview transcripts and recordings, is on file with the author, subject to the confidentiality agreements signed with the participants. *See infra* note 59.

55. *See* NEW BRIDGE STREET CONSULTANTS, <http://www.nbsc.co.uk/> (accessed July 30, 2007); TOWERS PERRIN, http://www.towersperrin.com/tp/jsp/masterbrand_lobby.jsp (accessed July 30, 2007); WATSON WYATT, <http://www.watsonwyatt.com/europe/> (accessed July 30, 2007). Following the merger of Towers Perrin and Watson Wyatt, their websites are no longer online. The source material for the information provided by these two sources is on file with the author and the Vanderbilt Law Review. The selection of the consultancies was based on the analysis by Conyon et al., *supra* note 3, at 49.

In line with other research findings,⁵⁶ all but one of the twelve companies participating in this research used remuneration consultants to advise on their schemes.⁵⁷ As regards the number of consultants used, the situation was quite complex and is summarized in Table 2.

Table 2: Number of Consultants Used⁵⁸

Number of consultants used for advice on schemes	Number of companies doing this
One firm of consultants used at any one time. (For four of these companies there was an ongoing relationship with the consultants—although two had changed consultants in the last couple of years. The other company used different consultants as appropriate.)	5
Two firms employed at the same time, one being the main consultant and the other for specific plan advice or a review.	4
Two firms employed at the same time, one for the company/management and the other to advise the remuneration committee.	2
No consultants employed for advice.	1

The research approach, using semistructured interviews, does not lend itself to statistical analysis of the results. Table 3 sets out the range of responses and practices the participants discussed.

56. This level of use of consultants is in line with the findings of Conyon et al., *supra* note 3, at 47–49, and Murphy & Sandino, *supra* note 3, at 249–50.

57. The protagonists in the company that did not use consultants felt quite strongly about this. See *infra* Part IV.F.

58. The interviews were conducted before the DRRR came into force. For a more current view, the latest remuneration reports (2008–2010) were reviewed for nine of the twelve companies (the other three no longer exist independently). They showed that one company used three consultants, three companies used two consultancies, and the remaining five used just one consultancy firm for advice to the remuneration committee. These figures and Table 2 exclude use of consultants for data on comparator pay levels; companies used several sources for this.

Table 3: Practices Discussed by Participants⁵⁹

Tenure of the consultants	One company used different consultants each time; some companies had changed consultants within the last two to three years; several had kept the same consultants for “quite a few years.” ⁶⁰
Use of consultants to liaise with the institutional investors	Of the eleven companies using consultants, five used them to liaise with the institutions, and one used the consultants to draft a letter that went out in the remuneration committee chairman’s name. When the consultants were liaising with the institutions, this was generally (but not always) done together with the remuneration committee chairman and/or the HR director.
Consultant attendance at remuneration committee meetings	In none of the case companies did the consultant automatically attend every remuneration committee meeting. Attendance was on an ad hoc basis, generally related to the introduction of a new scheme.
Use of consultants to help write the committee’s published remuneration report	In three of the companies, the remuneration committee asked the consultants to provide significant input to the remuneration report.
Separate consultant for committee and for other company activity	In two of the companies, it was standard to have separate advisors for the committee and the executive. One other company had done so in the past, and another used its own consultants to advise on the introduction of a new scheme.
Appointment of consultants by either the committee or the executive (e.g., HR function)	There was a wide range of practices. In one case, the remuneration committee controlled the process, with minimal involvement of executives. In several companies, the appointment appeared to have arisen with input from the non-executives and the executives. In two companies, the HR function made the decision with minimal committee involvement.

A. How Companies Choose Their Consultants

In selecting remuneration consultants, the consulting firm’s reputation was an important factor in all of the case companies. Personal recommendations also influenced the choice, for example,

59. Confidentiality requirements agreed with participants mean that further detail of the responses cannot be disclosed.

60. This is based on interviewees’ recollections. Data were not always available to enable the author to determine the exact tenure of the remuneration consultants.

from a board member who had worked with the firm or the particular individual consultant before.

In a few cases the selection was a matter for the remuneration committee, with little input from the executives, although in some instances the HR director made recommendations for a shortlist for the remuneration committee to consider. In other cases, the HR professional chose the consultants outright. Overall, there was no common thread in how the consultants had been engaged. As one consultant noted:

We were invited by [the HR director and manager]. One doesn't always know the background to this, but we had done a lot of work for [committee chair's other company] for about fifteen years So I suspect, although I have no way of knowing, that that helped us to win the project.

In this case, the appointment was made via the HR function, although all of the parties interviewed were of the opinion that the relationship with the committee chair had been an advantage in getting appointed.

Personal relationships were mentioned in several of the interviews. For example, some interviewees mentioned that the consultants were chosen because they had acted for another company known by the NEDs, or because the parties knew the consultants from attending seminars or other similar functions. In light of the fragmented nature of the executive compensation consultant industry and the fact that a select handful of firms dominate the industry,⁶¹ it is not surprising that the major consultancy firms are well known by many of the decisionmakers.

In the case above, no mention was made of any shortlist or "beauty parade" in the consultant appointment process. This differed from the process in another company, where the committee made the decision to change advisors due to the longevity of their appointment and their resultant closeness to management. The HR professionals made suggestions but then stood back from the process, and the remuneration committee made the ultimate selection:

And the committee's just changed its external advisers. They did that really without our help. We set up the beauty contest and the process, but they made those decisions on their own. Paradoxically they asked at the last minute if we were going to be involved. We said that we never envisaged that we would be responsible for selecting your external advisers. (HR professional)

This was at variance with the comments made by the HR director of another case company, who had himself made the

61. Conyon et al., *supra* note 3, at 49–50.

appointment because “the remuneration committee aren’t the remotest bit interested.”

Importantly, the majority of the interviews were carried out between late 2001 and early 2003, a time when the remuneration landscape in the United Kingdom was changing and, in particular, there was a drive for more rigor in the process.⁶² The effect of these changes is captured in the following long quote, which shows how one company decided to involve the committee more.

Well, essentially, historically the company⁶³ has tended to put forward a proposal to the remuneration committee to say, “Look, we’re going to work with [consultant name] on this, is that OK? Any objections?” But we’ve actually got a project that we are about to start now, and we’ve agreed a new process whereby although we still basically review and go through the tender process, the chairman of the remuneration committee is also involved and actually would sign the engagement letter. So we actually have moved from it being largely company-driven to it being a genuine joint appointment. And I think it’s fair to say it’s a joint appointment. And if anything, we can say that the remuneration committee had the right of veto. So if [the chairman of the remuneration committee] did not like the firm or the individual lead consultant, then we would abide by his wishes and have to re-tender again. (HR professional)

This involvement of the committee is qualitatively different from the example given earlier, where the committee was in control of the process.⁶⁴

In summary, although the case companies chose their consultants in different ways, a common thread was present in the

62. The regulations and announcements during that period were as follows. DEPARTMENT OF TRADE AND INDUSTRY, DIRECTORS’ REMUNERATION: A CONSULTATIVE DOCUMENT (2001) (U.K.), available at http://webarchive.nationalarchives.gov.uk/tna/+http://www.dti.gov.uk/cld/dir_rem.pdf/. In June 2002 Ministers proposed regulations to force companies to disclose pay and put remuneration policies to a shareholder vote. Tony Tassell, *Ministers Move on Excessive Executive Salaries*, FIN. TIMES, June 26, 2002, at 2. The formal regulations on disclosure of directors’ remuneration came into force on August 1, 2002, as the DRRR, *supra* note 4. In 2002 the IASB issued an exposure draft that had an impact on how companies viewed options-based compensation. EXPOSURE DRAFT 2, SHARE-BASED PAYMENT, available at <http://www.fas123.solutions.com/documents/ED2%20from%20IASB.pdf>. The whole role of the NED was re-examined again in DEREK HIGGS, DEPT OF TRADE & INDUS., REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (2003), available at <http://www.berr.gov.uk/files/file23012.pdf>. A few months later the Department of Trade and Industry (the “DTI”) returned to the subject of executive pay, specifically as regards large payoffs for directors who were leaving. Julia Finch, *Hewitt to Act over Rewards for Failure*, THE GUARDIAN, Apr. 28, 2003, at 20. In May 2003, for the first time, a company’s remuneration report was voted down by shareholders. Geoff Dyer, *Investors Reject GSK Executive Pay Policy*, FIN. TIMES, May 20, 2003, at 1. DTI issued the consultation document “Rewards for Failure” in June 2003. DEPT OF TRADE & INDUS., “REWARDS FOR FAILURE” DIRECTORS’ REMUNERATION—CONTRACTS, PERFORMANCE AND SEVERANCE (2003). Finally within this period, a revised version of the Combined Code was issued on July 23, 2003. FIN. REPORTING COUNCIL, COMBINED CODE ON CORPORATE GOVERNANCE (2003), available at http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

63. By “the company” he actually meant the HR professionals.

64. Indeed, the following year’s published remuneration report stated that the consultants were appointed by “the company,” not specifically the committee.

rationale of each company's decision: they required the consultant to provide expertise and legitimacy to their compensation decisions.

B. The Consultant as an Expert

The role of the consultant as an expert is twofold. Firstly, consultants need a level of expertise to provide the advice their clients seek. Additionally, they need to *appear* as experts to influence potential clients to employ them, and to manage the expectations and impressions of existing clients.⁶⁵

Given that pay is benchmarked against the market, an evident and important role for the consultants is as a source of data for the executive compensation market. Although U.K. regulation on executive pay means that much comparator information is publicly available, using consultant-generated data has two main advantages. First, it outsources a mundane task, freeing up the time of HR professionals who otherwise would have to look at many individual annual reports for the underlying numbers. Second, the consultants' proprietary data are often more up-to-date and more detailed than the information contained in annual reports. The consultants' information is more expensive however; thus, companies often mix and match self-generated data and publicly available survey data with data from consultants.

It is common for companies to use more than one consultant as a source of data, even if they only have one consultant providing plan advice. The reason for this is threefold. First, they get more data to inform their decisions. Second, more sources of data are perceived to provide more legitimacy for the pay decision. And third, committees differentiate the consultants' offerings, with different firms perceived to have different strengths.

[A] lot of the information is in the public domain. However, the advantage of using some of the more up-to-date surveys rather than just the annual report data is that although you're not going to get it company-specific, you are going to get it up-to-date. So we take part and subscribe to surveys by [three consultancy firms named]. So we have a variety of in-house data from those companies that we use. And then we very often use the consultants then to verify some of that for us. (HR professional)

[Names two consultancies] They're now working together, because they both have slightly different advantages and together it would be perfect. [Consultant 1] do a massive amount of factual, it is just tables of facts for every company. And they do a separate report on the [sector], drawn from the same base and split that again into quoted and unquoted. . . . Whereas [Consultant 2] go deeper into that; but it's only a subset. So it's a subset deeper. And there's others that touch both of those. But between those two . . . the remuneration committee gets quite a broad insight. (HR professional)

65. See, e.g., CLARK, *supra* note 22.

Although the committees made use of the consultants' data, it is important to understand that they were aware of the potential flaws and biases. Comments were made to the effect that surveys were driving up executive pay levels, and in this respect individuals also discussed their impressions that some consultants were always slightly ahead of the others in the figures they produced. The following quotes are illustrative.

You get these reports from the consultants saying, "Look, the median salaries are now so much, and you are below it, and therefore you've got to go up to the median level or whatever you want to be." And then of course you say, "yes, of course, everybody does that, it just goes on and up and up." And so . . . you always need to look at those sort of arguments very sceptically. (NED)

These surveys are all indicative of what's going on in the marketplace; and in lots of ways they can be mechanisms for upping the ante. (HR professional)

And by the way, one of them—and I'm not going to say which—is a firm that I think never ceases to give information that you are underpaying. That's their stock in trade. (Committee chair)

The committee chair who made that last comment added that his committee could "see through" that advice and so they still used those consultants for data supply.⁶⁶ This is an important point: the consultants do not make the decision on the pay schemes, they merely advise. Several of the consultants emphasized that point, of which the following is representative.

But the ultimate decision is that of the company. It's the company that makes the offer of employment. It's the company that will reach its own decision, taking whatever advice it may get to take, the advice may come from the remuneration consultant. (Consultant)

The committee receives advice, but then has to choose what to do with it. One of the marks of a consultancy assignment is that it provides the views of that consultant or that firm, and their approach may differ from others in the field, or indeed may change from assignment to assignment.⁶⁷ One consultant was very open about the potential for differences between practices:

66. This company did not make the consultants' reports available for inspection, so the author could not determine whether they had indeed "seen through" the consultants' figures and acted accordingly. The significant increase in executive compensation over the last decade suggests that such action is not often pursued. See, for example, Kate Burgess, *Floored Boards*, FIN. TIMES, June 2, 2009, at 12, which quotes a U.K. survey by Incomes Data Services as showing median total pay of chief executives of FTSE 100 companies to have risen 167 percent between 2000 and 2008; that of full-time employees grew by 32 percent.

67. Chockalingam Viswesvaran & Murray Barrick, *Decision-Making Effects on Compensation Surveys: Implications for Market Wages*, 77 J. APPLIED PSYCHOL. 588, 595 (1992).

But in exactly that same situation another consultant may have slightly different views, because to a degree we all carry some of our personal baggage with us, whether we admit to it or not. (Consultant)

This can be seen in the way in which the firms approach assignments. The consultants will set out the range of remuneration in comparator companies (having themselves been very influential in the selection of those comparators), and they will show whether the target executive is at, above, or below median. But they do not make the decision as to what action to take; sometimes they do not even make a recommendation, but let the data speak for themselves.⁶⁸ And it should be the companies who control the process, not the consultants. Companies can choose how best to use their advisors.

And we're not a company that is very good anyway at using consultants by and large. So we didn't [in the past] use consultants at all, we used the [names of two consultancies] surveys, and made our own recommendations, and I went along and presented those recommendations. This time for this particular review we're using [consultancy name]. . . . And we're using them very specifically, not to review basic salaries, but to review the structure of the package and to make recommendations with regard to these two areas that I mentioned, as to how we deal with that. You know, if you're taking something away from people, do you compensate them and so on. So they're working with us. We don't anticipate that they'll be at this meeting. The new chairman is not desperately keen to involve them in the meeting unless it's absolutely essential, and he'd expect us to be on top of the numbers and the thinking. (HR professional)

These sentiments were reflected more broadly in a lot of the interviews. Although consultants are useful, employing them was not seen as lessening the responsibilities of the HR professionals to the remuneration committee, nor of the committee to the investor community. Advice is proffered; it need not be taken. One role for the chair of the remuneration committee is to take a major role in managing this process and in evaluating the quality of information provided.⁶⁹

Part of the consultants' expertise is evidenced in their proprietary data, but they also provide valuable expertise on the design and implementation of remuneration schemes, and on their likely acceptability to the institutional shareholders. Both of these are important to their clients.

Well, that was the recommendation of the consultant based on some research they'd done and current best practice in those types of schemes. (Committee chair)

And [consultancy name], particularly when we want to get across some of the technical issues, and where they can give assurance that other companies are doing similar

68. Although it is fair to say that the choice of the benchmarking data provides an anchor point which influences the committee's decisions. Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1128-30 (1974).

69. Main et al., *supra* note 6, at 229.

schemes—”this is nothing unusual, nothing to be alarmed about”— they play the “don’t frighten the horses” role, I think. (Company secretary)

In review of the websites of some of the prominent consultancies, this knowledge and expertise is highlighted, as shown in the examples below.⁷⁰

We support these disciplines with extensive compensation data capabilities for competitive benchmarking through our Global Compensation Databases and Executive Compensation Resources Online. (Towers Perrin)

Using Watson Wyatt’s proprietary long-term incentive valuation methodology, Present Economic Value (PEV), to place an appropriate value on long-term incentives. . . . (Watson Wyatt)

We complement our consultancy services with our unique database and continuous research programme. (New Bridge Street Consultants)

In particular, we have produced a modified Black-Scholes valuation model in order to value share option and long-term incentive grants. (New Bridge Street Consultants)

In parading their expertise to the world, the consultants are conducting an impression-management exercise, positioning themselves as an attractive source of advice. Their proprietary databases of pay statistics are backed up by their many published surveys and reports, together with seminars they run for the corporate and institutional communities. These activities combine to set them in people’s minds as competent advisors. This is reinforced by the status of their client lists: a blue-chip client base is another indicator of quality. The requirements of the DRRR mean that the names of the consultancy firms advising each company are now public knowledge. But in case there were any doubts, many consultants publish details of selected clients in their marketing literature and on their websites.

Consultants will also run tailored seminars for their clients, for example an annual update on relevant plan- and market-related matters. Again, this reinforces their position as experts, as well as providing a service that is appreciated by the NEDs.⁷¹

Consultants who have designed a sophisticated scheme have an incentive to package and commoditize it, along with a potential incentive to sell it to clients, sometimes without sufficient tailoring to their own contexts. The consultants’ recommendations need to be acceptable to their clients and recognizable to the rest of the corporate world, but consultants also need to demonstrate their ability to tailor

70. *See supra* note 55.

71. No formal training is currently required for an NED sitting on a remuneration committee. Three of the five NEDs interviewed specifically drew attention to the fact that part of their voluntary “continued professional development” activities included attending seminars provided by remuneration consultants.

their expertise to the needs of the company.⁷² In one case, for example, a new consultant was appointed because the committee and HR professional were dissatisfied with the output from the previous consultant, which was seen to be rather generic and insufficiently tailored to that business context.

It was a rambling report which was a collection of data and research. It was not “bespoke,” if you like. That was fundamentally the problem. (HR professional)

The following quote sums up the views of many interviewees on the flair and originality the consultants display in plan design:

And anyway, we were disappointed. I think probably the reason is that in fact these remuneration consultants are a herd, just like the investment community are a herd, and there is not actually very much original thought around. (Committee chair)⁷³

One final indication of impression management is worth mentioning. In presenting a draft of this Article to an outside remuneration consultant (who had not been involved in the research), he suggested that instead of referring to “remuneration schemes,” reference be made throughout to “remuneration plans.” He commented that many consultants prefer this latter term, as it carries less pejorative connotations and avoids notions of “scheming.” However, the interviewees (consultant and other) used both terms.

C. *The Consultant as an Intermediary*

An important role for the consultants, and one that reflects their role as experts, is to serve as the liaison between the remuneration committee, the institutional shareholders, and their representative bodies, such as the Association of British Insurers (“ABI”) and the National Association of Pension Funds (“NAPF”). In all of the companies that used consultants, the consultants had a part to play in this dialogue, orchestrating what was said, and often participating in the discussions. Consultants in some instances

72. It is an odd fact of the consultancy industry in general that whilst consultants claim to produce novel recommendations, and clients claim to employ them so to do, a consultant producing something too different from accepted practice will be treated with suspicion, and so fresh ideas can be stifled. The way in which consultants balance this tension is discussed by Andrew Sturdy, *The Consultancy Process—An Insecure Business?*, 34 J. MGMT. STUD. 389 (1997).

73. However, it is also fair to say that remuneration committees are not comfortable with the idea of adopting radically new schemes, as these are not “the norm” and might attract unwelcome attention from investors. See, e.g., BENDER, *supra* note 10, at 9 (noting the distinct tendency of companies to adopt schemes that are already in use, rather than implementing novel schemes); Bender, *supra* note 6, at 206–08 (discussing investor attention and isomorphic pressures that induce companies to act in similar ways); Conyon et al., *supra* note 6, at 486–88 (emphasizing that promotion of the industry norm); Kostliander, *supra* note 24, at 22–25 (discussing the difficulty in deviating from the dominant practice).

advised their clients on which shareholders should be addressed directly, and which should be advised through the ABI or NAPF. They also drafted letters for the chair of the remuneration committee to send to institutional shareholders, or even sent the letters under their own names. Consultants might also collate the responses on behalf of the company.

In relation to the long-term plans, which is what shareholders currently focus on because they have to vote on them, once we've decided on the type of plan and the conditions with the company, we would then go and talk to investors. This is before the formal shareholders circular is posted. We would either do that ourselves, or we would prepare a letter for the company to write, and then we would get involved behind the scenes and liaise through the Association of British Insurers. (Consultant)

This was often done because both the companies and the consultants felt that the consultants were more expert at “handling” the institutions.

Another reason for using the consultants as the liaison was because the consultants were the ones who had the expert knowledge about the plans—both the detail of the schemes and their acceptability in the marketplace.

Another institution came up with some very technical questions about EPS versus total value, total shareholder value as targets. And we just felt we needed [consultant name] to produce a few pie charts showing how many people accepted EPS versus total shareholder value. (Committee chair)

You're holding, actually, all the cards. One, you understand the arrangement better. You understand what each party doesn't know, and you are able to piece it together. Whereas if both parties on both sides had more knowledge to start off with, they would be able to talk more readily. But remn co chairmen, it's one of the things they do, and they are not experts in the whole thing. And therefore the conversation doesn't go . . . you're not talking at the right level to start off with, so how can you cover the breadth if you haven't got enough knowledge? Whereas the consultants can go from here to there easily. The institutions don't understand what you're actually giving them. So you actually have to take them through what you're giving them. (Consultant)⁷⁴

Indeed, the appointment of consultants sometimes related to how experienced they were with institutional liaison.

[Consultant name] are well-respected by the institutions, which is one of the reasons we would always be very keen to work with them. So we started the process with the institutional investors through [consultant name] early on in designing the scheme. So we wrote to all our major investors with the outline of the scheme, asking for their views. Through [individual's name], particularly, at [consultant name], who managed a lot of the initial investor reactions, we made some changes to the scheme, so we were very keen to ensure that we had no surprises at the AGM. It didn't quite guarantee

74. A conclusion that could be drawn from this quotation is that complex remuneration schemes are being drawn up and implemented without the full understanding of those charged with determining the remuneration or those voting on it. However, the sentiment was only expressed in this form by one of the consultancy firms interviewed, and was not evident in the other case companies.

everything. And that [the institutions] had understood why we were doing what we were doing. (HR professional)

Many of the consultants referred to the shareholding institutions in material on their websites, as these examples illustrate:⁷⁵

Institutional shareholders have strong views on executive remuneration and are prepared to vote against resolutions on remuneration at general meetings. You need to take their views into account when designing remuneration packages. (New Bridge Street Consultants)

Major investors are increasingly flexing their muscles and governments are taking an increasing interest in this area. (Watson Wyatt)

The subtext of this is that misreading the institutional shareholders could cause problems for the committee, and that consultants who have particular expertise in this area will avoid such difficulties. This reading reflects the general literature on consultancy, which suggests that consultants reinforce management uncertainty and insecurity, and then sell their services as providing reassurance against these anxieties.⁷⁶

At least one consultant referred at interview specifically to their prowess in this area as an advantage in getting and keeping clients.

I genuinely believe that we know the views of investors [better] than any other firm you'll come across. (Consultant)

However, although the consultants relish this role, and although it is often useful to the companies, the shareholders and their representative bodies expressed a clear preference to talk to the committee members themselves rather than passing everything through consultants.

It's mostly us [who do the liaison]. But it is changing. There is a pressure from the institutions that they want to see the company, really, rather than us. Which in some ways I understand. . . . That dynamic is changing. (Consultant)

The company can put forward the chairman of the committee, the HR professional or the consultants. At different stages in the process, each could be acceptable. But for the set piece meeting when they are explaining to [us] what they are proposing to do, that should be led by the remuneration committee chairman. And it's good if the chairman can come without the consultants: it looks better. (Institutional representative)

75. See *supra* note 55.

76. Sturdy, *supra* note 73, at 408–09.

D. The Consultant as a Legitimizing Device

A fundamental part of the consultant's role is to provide legitimacy for the decisions of the remuneration committee. This was evidenced in several ways during the interviews.

In some instances, interviewees took the view that, although it was not compulsory to employ consultants, it was seen as highly desirable because it demonstrated that the committee had accessed independent expertise.⁷⁷

[I]n due course, the way the DTI is going, the DTI will expect that you have taken some outside views on salaries. And therefore there's no point any longer in saying, "I'm not going to do that, it's a waste of money." I think that one of the criteria which we're told will come out with the DTI paper is that they will insist that you have taken some formal benchmarking exercises in arriving at salaries, so that's what we've done. (NED)

I think it was two years ago, in the light of corporate governance issues generally, I was very concerned about our remuneration committee having its own specific and independent advice. So it was my suggestion that we have a beauty parade and we actually appoint a consultant to the remuneration committee. (HR professional)

You have to use consultants to value things. Because people expect an outside independent valuation. (HR professional)

Other participants were anxious to highlight to the researcher the probity of their processes, as evidenced by the involvement of consultants.

[Our committee] would never have a meeting to discuss directors' or senior managers' pay without surveys or consultants' documentation, to which it would pay close attention. (NED)

Some were very blunt about the use of consultants as a legitimizing exercise.

But I do think, there is no doubt that part of this process is a covering of the back. It allows the board to say that it has consulted with consultants. (NED)

Interestingly, in two companies the HR professionals felt that the presence of consultants was also useful to legitimize their own recommendations to the remuneration committee, in that the committee would give more credence to those recommendations because of the authority the consultants conferred.

77. See ANNALISA BARRETT & PAULA TODD, TOWERS PERRIN, NACD BLUE RIBBON COMMISSION REPORT ON EXECUTIVE COMPENSATION AND THE ROLE OF THE COMPENSATION COMMITTEE 2 (2003), available at http://corpgov.net/wp-content/uploads/2010/11/NACD_BRC_Report.pdf (making a specific recommendation to "[e]nsure that committee has access to appropriate independent expertise"). In the United Kingdom, see GREENBURY REPORT, *supra* note 50, para. 4.17, for the suggestion that it is appropriate for the committee to draw upon outside advice.

We'd obviously have to get the consultants on board. I think if they're saying this is a perfectly good idea then we tend to have the committee saying, well fine. (HR professional)

Because in the end we realized that anything that went to the remuneration committee, if it had the sign-off of the external advisers, for want of a better phrase, it stood a better chance of getting through the remuneration committee. (HR professional)

Overall, it is apparent that each company believed that consultants play an important part in legitimizing decisions, both internally and externally, and that this ability to confer legitimacy was frequently featured in the consultant selection process. Nonetheless, as discussed in the next Section, there are problems in using consultants to provide legitimacy for the committee's decisions.

E. Conflicts of Interest and the Appointment of More Than One Consultant

Many companies use more than one consultant as a source of data on market norms. Some also use different consultants for different parts of the package, choosing, for example, one firm to advise on pensions and another for the rest of the package, or one for normal activity and another when considering changes to the plans. However, although it is not universal practice, it has become more common to see companies using separate consultancies to advise management and the remuneration committee. One obvious reason for this is the potential for "capture" of a consultant serving management, which has the ability to award considerable fee-earning work.⁷⁸ Although it is not always borne out in academic research, press commentary often highlights this view.⁷⁹ The potential for conflicts of interest was acknowledged by the consultants themselves.

And, you know, obviously people put pressure on you to change different elements of the report. . . . I think that's when it does make a difference who we're reporting to. If we're reporting to the executive team or we're reporting to the remuneration committee. . . . We have been involved in situations where the executive team is trying to put a bit of pressure on to you, and in the end something has been put forward to the remuneration committee but it may not have our name on it, in the sense that we then don't feel that that fully represents our views. Whether the remuneration committee is aware of that is another point, because, you know, in some cases we don't see [the committee].
(Consultant)

78. See *supra* note 2 for examples of concern over conflicting consultant interests leading to escalated executive compensation.

79. One reporter deemed pay consultants "an unregulated and conflicted bunch" and an insufficient bulwark against misaligned executive compensation. Plender, *supra* note 28. For research, see the studies referenced *supra* note 3. However, note that Kostander does find evidence of capture, in the very specific context of Finnish state owned enterprises. Kostander, *supra* note 24, at 31.

But yes you do come across difficulties between the execs who have appointed you or the remuneration committee who have appointed you. And that's when you've got to know who appointed you. Because at the end of the day if there is a conflict, you've got to go back to the people who appointed you and say, "look I cannot advise both of you."
(Consultant)

One instance of capture in particular was raised with regard to conflicts of interest—more than one consultant made the comment that if a plan “goes wrong” (that is, does not pay out enough) then the consultant’s appointment may be terminated. They are treated as a scapegoat—as one consultant put it, “you’re identified with failure.” A very public example of this in the United States was Countrywide Financial, which reportedly changed consultants in order to obtain a more generous compensation package for its chief executive.⁸⁰

Interviews with consultants on this potential conflict of interest produced mixed results. Some acknowledged this potential problem, but stressed that they remained conscious of the fact that the committee, not management, was their client, and their advice was given in that context. They commented that their respect for their own professional reputations would not let them give partisan advice.

I think what is important is the independence of an adviser to a remuneration committee. And that independence is important. It's important to the committee, and it's important to all of the other interested parties, including the executive population. Including shareholders, whether they be private shareholders or institutional shareholders. I think there are also some pressures on consultants to maintain that position of independence. I have a kind of shorthand way of describing it. If you provide advice to a committee, that advice should be such that if it were published, you as a consultant would be able to defend it. (Consultant)

It is worth noting that credit rating agencies and firms of auditors have used the same argument of professionalism and reputation. Evidence presented to the U.S. House of Representatives oversight committee has shown that the credit rating agencies succumbed to the pressures of the conflict.⁸¹ The events surrounding Enron indicated that at least one of the large auditing firms also acted inappropriately.⁸² U.K. regulators, unconvinced by the consultants’ protestations of professional independence, recommended that

80. David S. Hilzenrath, *Whom Do Consultants on Pay Work For?; House Report Says Countrywide Adviser Boosted CEO*, WASH. POST, Mar. 8, 2008, at D1. For United Kingdom examples of firms changing their remuneration schemes and the rationales behind doing so, see Ruth Bender, *Onwards and Upwards: Why Companies Change Their Executive Remuneration Schemes, and Why This Leads to Increases in Pay*, 15 CORP. GOVERNANCE 709, 713 (2007).

81. Alan Beattie, *Rating Bodies 'Broke Bond of Trust'*, FIN. TIMES, Oct. 23, 2008, at 7.

82. See Ken Brown & Ianthe Jeanne Dugan, *Sad Account: Andersen's Fall from Grace Is a Tale of Greed and Miscues*, WALL ST. J., June 7, 2002, at A1 (recounting how an Andersen auditor was removed from Enron’s account after showing resistance to Enron’s accounting practices).

consultants adopt codes of best practice to mitigate such conflicts in the future, and this has since been addressed.⁸³

Companies use remuneration consultants for much more than advice on executive pay. Accordingly, if separate consultants are employed to advise the remuneration committee, the company will need to employ at least two firms. Various views were expressed on the pros and cons of employing separate consultants for management and the committee, either as one-offs or permanently. Some companies had had multiple consultants for a number of years, and took it as the norm.

[I]t's part of our core corporate governance policy that the remn co will be independently advised. (Company secretary)

Other companies had brought in a dual structure, as they saw it as emerging best practice and as one which confirmed the legitimacy of the advice they were getting.

We've brought [Consultant 2] in because we'd always used [Consultant 1]. And we wanted to make sure that, from the remuneration committee's perspective, they felt ownership of the research being undertaken, and that it wasn't, if you like, a management tool. I don't think there was any suspicion of that, it was just . . . because [Consultant 1 had] always been engaged by management . . . I think it would just have looked wrong. (Company secretary)

However, some companies—and some consultants—saw the idea of two consultants as an unnecessary expense, and one with the potential for conflict, as the consultants played off against each other.

Now in that sort of frame of mind you don't say across the table to [CEO], "you've got your independent advisers, and I've got mine." You say, and this is how it would come about, and I hope it never did because it would suggest crisis, by which time the independence of the consultants, whatever area it's in, would be irrelevant. You say, "we don't trust you . . . and we don't trust you and your colleagues to give us the right information." That would be the point in time where I think a resignation would be a swifter way of bringing the crisis to a head than saying please bring in [consultants] to review this on our behalf because we don't like you working with whoever else it is. (Committee chair)

Not really, no, I don't believe it does work. Provided that whatever adviser is being used is a professional adviser, the advice that is being given—notwithstanding the comments of some institutions—will actually be well thought out, professional, and therefore the added value that another adviser can provide in terms of reviewing that will tend to be

83. The U.K. Treasury Committee suggested that remuneration consultants should adopt a code of ethics. UK TREASURY COMMITTEE REPORT, *supra* note 2, para. 82. The Remuneration Consultants Group, comprising consultants advising at least one FTSE 350 remuneration committee, produced the VOLUNTARY CODE OF CONDUCT IN RELATION TO EXECUTIVE REMUNERATION CONSULTING IN THE UNITED KINGDOM (2009), available at <http://www.remunerationconsultantsgroup.com/assets/Docs/The%20Code%20November%202009.pdf>. The recent spinoffs of executive compensation consultants reflect the firms' realization that they need to address these issues. See *supra* Part II.C.

relatively limited. And it will be more matters of opinion rather than fundamentally saying “okay, this is wrong.” (Consultant)

I think if you’ve got consultants who’ve got integrity, it’s probably a waste of money. (Consultant)

One of the consultants illustrated the potential for conflict with reference to a company he had advised (not one of the case companies) where using separate consultancy firms for management and the committee had potentially led to increased packages.

[W]hen I first started to advise I was already on notice that the executives were taking advice elsewhere. And they would come along to the remuneration committee looking at one particular aspect of the remuneration package, whereas I was trying to take the remuneration committee continuously down the line of total remuneration. And it’s so easy to do a knee-jerk reaction and say oh gosh, yes that data shows that our bonus plan is so far behind the market . . . (Consultant)⁸⁴

The consultant pointed out that, although this issue had arisen with management and the committee using different consultants, it could also be a problem where a company or committee chose to use different consultants for different parts of the package.

F. An Argument Against the Use of Consultants

As noted previously, eleven of the twelve case companies used consultants to advise on plans.⁸⁵ One did not. A very experienced HR professional served this company. His thesis was that in order to design an appropriate scheme, the designer needed a good understanding both of plans and of the company’s particular context and culture. Given his background, he believed that he was more than able to match the consultants’ knowledge of plans. And, quite reasonably, he argued that his knowledge of the company had to be deeper than any external consultant could obtain. Thus he saw little point in appointing external advisors.

I’m horrified when a lot of companies introduce new share schemes, and the discussions with shareholders are led by consultants. . . . But they ought to know the scheme. That’s what I mean. We would expect that we’d invent the scheme, not the consultants. It’s an appalling thought to me to have a consultant to invent schemes for me. How could I keep my self-respect if that happened? That’s what I can’t understand really, the way other companies do it. Because with most consultants you will get their pet scheme. How do you know if that’s going to be any good for you? You want your own scheme. (HR professional)

84. This consultant also commented on the need for integrity in dealing with some remuneration committees (again, not in the case companies) who wanted justification for increasing pay, for example by retrospectively redefining the calculations underlying a performance measure.

85. See *supra* note 57.

This view was supported in the interview with the chair of his company's remuneration committee, who commented that the matter was discussed with the committee annually, but that they saw no benefit in using such advisors.⁸⁶ A review of the company's remuneration report in the financial statements following the interview date (by which time the new reporting requirements were in force) showed that the company had since appointed consultants, but that their role was specifically stated as being one of verification rather than advisory.

However, tracking the company's remuneration reports in subsequent years showed that the committee chair had since retired (which appears to have coincided with the retirement of the senior HR professional). In the following year, the committee appointed compensation consultants for plan advice. This brief case study illustrates the influence of individuals on policies, and lends support to a comment made by Martin Conyon et al. that "those firms without consultants may be idiosyncratic."⁸⁷

V. DISCUSSION

Remuneration committees use consultants not only as experts, but also for risk-management purposes to legitimize their decisions in a contentious area. However, this can only be achieved if the consultants themselves have legitimacy. Accordingly, in interpreting these findings we must consider the approaches taken by both committees and consultants.

It is useful to consider exactly what is meant by "legitimacy" and how it is obtained. One definition of legitimacy is "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."⁸⁸ Within a taxonomy of legitimacies, the one that resonates with this discussion is procedural legitimacy: "procedural legitimacy becomes most significant in the absence of clear outcome measures . . . when 'sound practices' may serve to demonstrate that the organization is making a good-faith effort to achieve valued, albeit invisible, ends."⁸⁹

This notion encapsulates the problem the remuneration committee faces. There is no clear outcome measure, because there is

86. The HR professional was present during that interview, and the point was not pursued in the conversation.

87. Conyon et al., *supra* note 3, at 49.

88. Suchman, *supra* note 40, at 574.

89. *Id.* at 580.

no right answer in issues of executive remuneration. There are, however, many wrong answers, as companies facing censure by media and regulators will testify. So, having processes in accord with “best practice” can provide legitimacy, immunizing the committee against accusations of bias or imprudence.⁹⁰ Following best practice may not be a *sufficient* condition to escape criticism, but the findings of this research suggest that the interviewees and their committees believe it almost certainly to be a *necessary* one. Alistair Bruce et al. comment specifically on the role of remuneration consultants in this.

Occasional executive pay crises are readily dealt with through the firm’s remuneration committee utilizing specialized consultants and maintaining communication with institutional investors. But, by and large, the conventions of conformity to codes (such as that of the ABI) and adherence to procedures (such as seeking independent advice of remuneration consultants and utilizing the remuneration report to explain the basis of pay awards) provides executive pay with a legitimacy that would otherwise be absent.⁹¹

Organizations can become legitimate by adopting structures and procedures in line with their institutional environment.⁹² Adopting these processes is a risk-management tool. Companies that do not do things by the book could be vulnerable to claims of negligence, whereas following a defined process provides a defense. “[M]anagers whose plans have failed can demonstrate to investors, stockholders, and superiors that procedures were prudent and that decisions were made by rational means.”⁹³

This idea of legitimacy links closely to neo-institutional theory’s concepts of isomorphism. It suggests that there is a “best practice,” or at least a commonly accepted “good” practice, which committees can follow. Such a convergence of practices is explained by coercive, mimetic, or normative isomorphism.⁹⁴ In the arena of executive compensation, all three are visible.⁹⁵ In particular, the use of remuneration consultants has become a part of good practice.⁹⁶

90. See Kimberly D. Elsbach & Robert I. Sutton, *Acquiring Organizational Legitimacy Through Illegitimate Actions: A Marriage of Institutional and Impression Management Theories*, 35 ACAD. MGMT. J. 699, 700 (1992) (discussing how organizations seeking legitimacy can avoid conferring negative impressions by employing socially acceptable procedures).

91. Alistair Bruce et al., *Top Executive Remuneration: A View from Europe*, 42 J. MGMT. STUD. 1493, 1499 (2005).

92. John W. Meyer & Brian Rowan, *Institutionalized Organizations: Formal Structure as Myth and Ceremony*, 83 AM. J. SOC. 340, 349 (1977).

93. *Id.* at 350.

94. See DiMaggio & Powell, *supra* note 19, at 150 (describing coercive, mimetic, and normative isomorphism as the three mechanisms driving institutional isomorphic change).

95. Main et al., *supra* note 6, at 234; *see also* Bender, *supra* note 6, at 212–13.

96. Wade et al., *supra* note 38, at 644; *see also* Bruce et al., *supra* note 91, at 1499 (pointing out how utilizing independent consultants is a procedure often followed to legitimize executive pay).

Indeed, the Greenbury Study Group, which was the foundation of U.K. regulation in this area, legitimized some of its own findings with reference to the remuneration consultants it had used for advice, and set out a “Code of Best Practice,” which in several places made the assumption that companies would use consultants to provide data and advice.⁹⁷

Remuneration committees use consultants to legitimize their decisions. But as we have seen, the consultants themselves are under attack due to a perception that their recommendations are swayed by their potential conflict of interest. So, how do they maintain their own legitimacy? One way to do this is to foresee changes in the environment and adapt to these before they become serious.⁹⁸ It could be said that the damning reports of legislators in the United Kingdom and United States indicate that they missed this chance.⁹⁹ Nevertheless, the consultancy firms have changed and are changing their practices to accommodate the new circumstances. By spinning off separate practices, implementing Chinese walls, and changing their operational practices, they are demonstrating an understanding of what has alarmed outside constituencies. And by “professionalizing,” with the larger firms in the United Kingdom joining together to produce a voluntary Code of Conduct,¹⁰⁰ they are trying to take charge of the debate themselves, rather than have regulation imposed upon them.¹⁰¹

Changes in the environment in which remuneration decisions are made are leading to changes in committees’ decisionmaking processes. However, the participation of remuneration consultants in these processes is institutionalized and embedded in perceived good practice. As the pay landscape shifts, their role will adapt, but will not disappear.

97. GREENBURY REPORT, *supra* note 50, §§ A7, C2, C8, para. 4.17.

98. As suggested by Suchman, *supra* note 40, at 594–95, in which he describes perceiving future changes as one of two major ways organizations maintain legitimacy.

99. See, e.g., WAXMAN REPORT, *supra* note 2, at 32–33; UK TREASURY COMMITTEE REPORT, *supra* note 2, paras. 79–82.

100. See *supra* note 83 for the Remuneration Consultant Group’s framework establishing the Code of Conduct, and for the Code of Conduct itself.

101. This is a very British approach to a governance crisis. The Greenbury Study Group, which was a non-governmental body set up by the Confederation for British Industry, addressed public outrage about executive remuneration. GREENBURY REPORT, *supra* note 50, at 7. And the 1992 Cadbury Committee for Corporate Governance, on whose final report so many governance regulations are based, was not formed by the Government, but was set up by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession. Laura F. Spira, *Audit Committees: Begging the Question*, 11 CORP. GOVERNANCE 180, 181 (2003).

VI. CONCLUSION

This Article adds a new chapter to the growing literature on compensation consultants, taking a qualitative approach to determine the reasons why remuneration committees employ consultants, and the ways in which they operate. Interviews were conducted with the protagonists in the remuneration-setting decision in a selection of FTSE 350 companies to determine why and how consultants are used. The interviews reveal several clearly distinguishable roles for the consultant. One function of the consultant is to act as an expert, providing proprietary data against which companies can benchmark pay, and giving insight and advice into the possibilities open for plan design and implementation. In this role, consultants have a direct and immediate influence on executive pay. That is, by influencing the choice of comparators, consultants both identify and drive the market for executive pay. They also bring to bear their knowledge of pay plans, and their views on what is currently acceptable to the market, thus spreading current practice more widely and institutionalizing it as “best practice.”

Consultants also act as liaisons—serving an important role in the communication with certain institutional investors. The perceived advantage of this is that they are experts, with experience in dealing with the institutions, and so can argue the case more effectively than could the company representatives on their own. Also, they can bring to bear extensive technical knowledge in their explanations. Nevertheless, as explained previously, in some cases the shareholders would prefer to see more of the committee members and less of their advisors.

A significant aspect of consultants’ work is to legitimize the decisions of the remuneration committee by providing an element of perceived independence. Executive pay is a contentious area, and this independent input into the process of determining executive pay provides some legitimacy for the outcome. However, this route to legitimacy is under threat as various constituencies question consultants’ independence. Consultants need to address this in order to maintain and enhance their own legitimacy, and to continue to be seen as a “best practice” solution. This Article has explored the ways in which legitimacy is developing for the committees and their consultants.

In summary, the interview-based research reported in this Article highlights the different roles played by compensation consultants and emphasizes the importance of their function in setting executive remuneration in selected large U.K. companies. The study provides a context for other papers in this field, and can be used by regulators and researchers to inform future work.