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Executive compensation and ethics. Perspective of the financial crisis

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Executive compensation is one of the most important corporate governance mechanisms which plays an incentive function suggesting the adequate size, structure and various components of the pay. Despite the fact that the evidence of executive remuneration motivational function is viewed as the crucial solution to the principal agent conflict, its pre-crisis practice indicated severe shortcomings. The inefficiencies of executive compensation practice related to the package size, bonus policy, incentive programs and the proportion of the variable component are viewed as the significant contributor to the outbreak of the financial crisis. The aim of the paper is to identify these elements of executive compensation which proved to be detrimental for shareholders and to relate them to business ethics. The article intends to show that that the misuse of executive remuneration is not only the corporate governance problem but incorporates severe ethical dilemmas questioning the fundamental assumption of the company functioning.

Keywords: executive compensation, executive remuneration, ethics, corporate governance, crisis.

Wynagrodzenie najwyższej kadry menedżerskiej a etyka. Perspektywa kryzysu finansowego

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Wynagrodzenie najwyższej kadry menedżerskiej zalicza się do najważniejszych mechanizmów nadzoru korporacyjnego i, rekomendując określoną wielkość, strukturę i rolę poszczególnych komponentów płacy, odgrywa istotną funkcję motywacyjną. Pomimo iż dorobek płacy menedżerskiej wraz z jej funkcją motywacyjną stanowi jedno z najistotniejszych osiągnięć dla łagodzenia konfliktu między pryncypałem a agentem, praktyki przedkryzysowe wskazują na poważne słabości stosowanych rozwiązań. Słabości dotyczące kwestii wielkości pakietów wynagrodzenia, polityki przyznawania premii, konstrukcji programów motywacyjnych i udziału komponentu ruchomego są uznawane za czynniki, które przyczyniły się do wybuchu kryzysu finansowego. Celem artykułu jest zidentyfikowanie głównych słabości praktyki wynagrodzenia najwyższej kadry menedżerskiej oraz odniesienie ich do aspektów etyki biznesu. Intencją autorki jest wykazanie, iż nieodpowiednia implementacja rozwiązań w zakresie płacy menedżerskiej stanowi nie tylko problem nadzoru korporacyjnego, lecz także obejmuje poważne dylematy etyczne i kwestionuje fundamentalne założenie funkcjonowania przedsiębiorstwa.

Słowa kluczowe: wynagrodzenie kierownictwa, etyka, ład korporacyjny, kryzys.

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1. Introduction

The outbreak of the financial crisis triggered in 2007 by the mortgage credit crunch on the American market revealed significant shortcomings in the functioning of the global financial system, particularly in the banking supervision, as well as in corporate governance (Smith, 2010; Boerner, 2008). The impact of the financial crisis, the long term consequences of the economic slowdown and structural problems exert pressure on the revision of the adopted solutions and accepted assumptions and principles (Stout, 2012; Bainbridge, 2010; Gordon, 2010). The course of the crisis also indicated that the main causes were rooted in the institutional, intellectual and moral failures (Posner, 2010, 40–79). Since inefficiencies in corporate governance were viewed as an significant contributor to the credit crunch more attention was given to the enforcement of governance principles and the practice of board work, executive compensation structure, disclosure standards and shareholder engagement (Cohan, 2010; Kansas, 2009; Isaksson, 2009). The main fundamental weaknesses of corporate governance included insufficient reliable information provided to the market, conflict of interest of different institutions such as investment funds and rating agencies, no objective assessment of executives, as well as indicated before, low effectiveness of the board work, low effectiveness of the executive compensation, low involvement of shareholders and their weak impact on the operation of companies (Kirkpatrick, 2009; Clarke and Chanlat, 2009, 1–42). Additionally, the critical comments refer to the low ethical standards and the pursuit of the shareholder value maximization which proved to be inefficient and de facto detrimental to the shareholders it should benefit (Stout, 2012). The reports and analysis of the outbreak and course of the financial crisis indicate that it is the executive remuneration that is most criticized and most frequently review as the driving force to the weaknesses of the overall corporate governance structure (Johnson et al., 2010; Bebchuk and Spamann, 2010). More importantly, the pre-crisis recommendations and recognized solution failed to the large extend undermining the faith in its role for shaping sound corporate governance (Clarke and Chanlat, 2009, 1–42). The practice of executive compensation with the reference to its structure, size and bonuses schemes neither solves the problem of opportunistic behavior of executives nor leads to creation of firm value. What is more, it may lead to a number of pathologies and result in poor performance leading to the collapse of the company (Kirkpatrick, 2009; Urbanek, 2010).

The aim of the paper is to identify the components and solutions of executive compensation which proved to be detrimental for shareholders, previously considered as the crucial achievement of corporate governance, and to relate them to business ethics. Discussing the executive compensation with respect to its pre-crisis characteristics and practice the article intends to show that that the misuse of executive remuneration is not only the

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corporate governance problem but incorporates severe ethical dilemmas questioning the fundamental assumption of the company functioning. The originality of the paper lies in the identification of links between business ethics and corporate governance, and more particular between the practice of executive remunerations. Addressing the ethical dimensions of the top managers pay the paper provides not only the perspective of efficiency of corporate governance mechanisms and the incentive function of compensation schemes but also raises doubts on the corporate practice with respect to ethical principles and accountability to a wider group of stakeholders. The paper contributes to the knowledge of corporate governance addressing three main issues: the efficiency of executive compensation and its pre-crisis practice, the ethical controversies revealed significantly in the times of financial crisis which outbreak was partially attributed to the shortcomings of both corporate control and motivation. The study is organized as follows: the first point discusses the role and importance of executive compensation in corporate governance indicating its incentive functions to motivate executive to act in the interests of shareholders. It also presents the characteristics of the executive pay and its main shortcomings. The second part presents the ethical dilemmas of remuneration packages discussing the most important shortcomings of the executive pay which are believed to contribute to the outbreak of the financial crisis. The third point presents directions for reforming corporate practices of executive compensation referring to the latest recommendations and regulations and addressing the identified ethical controversies. Final remarks are presented in the conclusion section.

2. Executive compensation as a corporate governance mechanism

2.1. The characteristics of executive compensation

Corporate governance is a structure to monitor as well as to motivate executives to act in the interest of shareholders (Mallin, 2004; Wolf, 1999; Shleifer and Vishny, 1997) and includes a set of control mechanisms such as board (supervisory board or board of directors), the presence of majority shareholders, the position and role of a creditor, and broadly understood possibilities to discipline the managers by the market mechanisms, such as the stock market, market for corporate control (hostile takeovers), debt market (bonds), market for executives and business culture (Allen and Gale, 2000; Zingales, 1997). The incentive component of corporate governance is provided by the executive compensation including a number of different motivating programs (Bebchuk and Fried, 2003; Mallin, 2004). As discussed by the principal agent theory the various time horizon, diversification possibilities and information asymmetry impact the position and leads to different usually conflicting goals of executives and shareholders (Fama and Jensen,

1983a; 1983b). The importance of the executive pay lies in its motivational function to limit conflicts between principals (Jensen and Meckling, 1976; Mikołajek-Gocejna, 2010). Therefore executive compensation is viewed as one of the most important incentive mechanisms supporting the alignment of the interests of managers to those of shareholders traditionally and plays crucial role on the corporate governance system (Monks and Minow, 2004). Its importance is rooted in the fundamental assumption of the link between executive pay and company performance assured by the presence of a variable component to the remuneration package. The variable, performance related part of the pay element is paid to the executive on the basis of the financial and market performance taking the form of the form of bonuses, stock options, restrictive shares and long term motivational plans. The performance related component is believed to provide a strong incentive to act in the interest of shareholders and increase firm value results make for significant proportion of the pay. The variable component which may reach the level of as much as 75–80% of the pay in are believed to have the strongest incentive influence on executive contribution to corporate performance function (Mallin, 2004; Bebchuk and Fried, 2004).

2.2. The pre-crisis practice of executive compensation

The pre-crisis corporate practice assumed the efficiency of executive compensation with respect to creating shareholder value adopting a set of recommendations on the remuneration size, structure and payout schemes. The characteristics of pre-crisis executive pay was the following (Henderson, 2008; Clementi and Coley, 2009; Jensen and Murphy, 1999; Bebchuk and Fried, 2004):

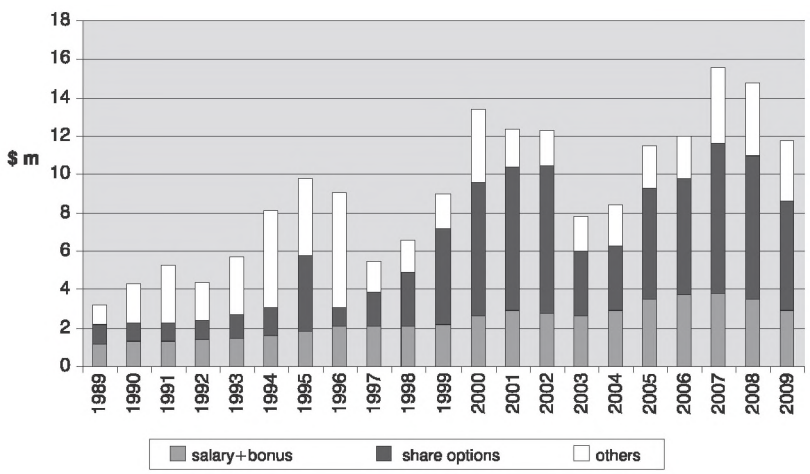

Figure 1. The size and structure of executive compensation 1990–2009. Source: based on Forbes Executive Compensation reports (2009).

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- The significant size and dynamic increase of executive compensation – while before 1990 the average CEO pay was estimated at $3 million, after 1990 it showed significant growth. The highest level of executive pay on average was recorded in 2007 and amounted to $16 million representing the rise by 500% over 20 years (Bebchuk and Fried, 2004). The trend is presented in Figure 1. The rise of executive remuneration pay estimated at 75% over the period of 2002–2007 was noted in Europe, respectively. The average executive pay in Europe rose in this period from about €1.5 to over €2.7 million, with the highest rise in variable component: from about €700,000 to €1.5 million annually.
- As shown in Figure 1 the significant growth of the executive pay is rooted in the increase of its variable component which is believed to serve as an efficient incentive mechanism. The performance related pay is to mitigate the principal–agent conflict, to encourage executives to enhance corporate performance and to contribute to shareholder value.
- The growing gap between executive pay and workers' pay reached the level of 300 times while this gap accounted for 25 times in the 60s, 35 times at the beginning of the 80s, towards the end of the 90s and the level of 100 times (Clementi and Coley, 2009; AFL-ACIO, 2011). The detachment of skyrocketing executive compensation from average worker pay is severely criticized for its discouraging impact on the employees and public negative perception.
- The short term orientation of the executive pay, bonuses tied to short term performance and paid mostly in cash as well as the dominance of financial indicators in the evaluation of corporate performance were viewed as a solution encouraging executives to take more risk (Kirpatrick, 2009; Isaksson, 2009). Moreover, as the remuneration was linked to the turnover, such schemes were believed to contribute to boosting sales however at the cost of sustainability and reliability of the performance in the long run.

The practice of executive compensation proved to be problematic and casted doubts on its efficiency from the perspective of corporate governance and incentive functions. The practice of executive compensation in the pre-crisis area with respect to the size, structure, payout and incentive schemes revealed departure from the fundamental assumptions of sound corporate governance. Table 1 presents the side effects of the crucial aspects of the executive pay which for a longer time was perceived as one of the most important achievement of corporate governance and constituted the essentials of corporate practice.

As shown in Table 1 the first side effect of the executive pay refers to the structuring of the remuneration package into the fixed salary and the variable component. Although such pay structure was viewed as the fundamental recommendation to tie the interest of executives with those of shareholders the inefficiencies of these scheme motivated executives for the

Recommendation	Main argument	Observed side effect
Remuneration package structured into fixed pay and variable component	Tying the interests of executive with those of shareholders	Increased risk, the tendency to increasing executive remuneration package
Bonus tied to achieved results	Motivating executives for pursuing selected financial and market goals	Increase of short term orientation, increased risk taking, pathological scheme of 'guarantied bonus'
Stock option and their value depend on the company share price	Motivating executives for maximizing shareholder value	Tendency to manipulate share price in the periods when stock options are to be exercised
Restricted shares	Making executive to feel like a shareholder	No positive effect or increase of the executives influence in internal matters (e.g. voting)
Increase of the pay size	Attracting the best executives	Exaggerated size of the pay; boosting self confidence and ego of executives, unlimited demand for pay rise
Severance pay	Preventing executives from blocking major changes in companies, easy exit	Exaggerated packages
Increased disclosure of executive pay	Transparency, investor protection	Increase of the pay size

Table 1. Corporate governance arguments of executive pay and their side effects. Source: own compilation based on S. Johnson, H. Ryan and Y. Tian. (2010). Managerial incentives and corporate fraud: the sources of incentives matter, http://www.ssrn.com/abstract=395960 (21.01.2010); L. Bebchuk and J. Fried. (2004). Pay without performance: Unfulfilled promise of executive compensation. Harvard University Press; G. Kirkpatrick. (2009). The corporate governance lessons from the financial crisis. OCED, http://www.oecd.org/dataoecd/32/1/42229620.pdf (21.01.2010) and J. Gillespie and D. Zweig. (2010). Money for nothing. How the failure of corporate boards is ruining American business and costing us trillions. New York: Free Press.

excessive risk taking and lead to the tendency of increasing executive remuneration package (Kirkpatrick, 2009). The incentive function of the bonus which was to encourage executives to pursue selected financial and market goals was twisted in line with the increase of the short term orientation, the concentration on the boosting turnover and sales, increased risk taking (Gillespie and Zweig, 2010). It also gave rise to the pathological practice of 'guarantied bonus' which was to be paid to executives irrespective to the company's results and contradicted the fundamental assumption of the bonus as a motivation mechanism (Gillespie and Zweig, 2010). Additional shortcomings of executive compensation were seen in the case of American companies which were on the brink of collapse and on the saving of which the American government decided to spend billions of dollars (Clarke and Chanlat, 2009; Kansas, 2009; Neumann International AG, 2010). The next shortcoming of the executive remuneration refers to the exaggerated

 DOI 10.7172/1644-9584.46.6

size of the pay which by definition was supposed to attract the best executives but it resulted in boosting self confidence and ego of executives and contributed to the unlimited demand for the continuous pay rise. The inefficiencies of the severance pay which was to allow for an easy exit for inefficient executives and was intended to prevent executives from blocking major changes in companies, led to the problems of excessive packages estimated at 300% of annual pay (Gillespie and Zweig, 2010). Finally, the shareholders' expectations to increase disclosure of the executive pay was to provide for higher transparency but in the consequence led to the increase of the pay size as executives strengthen their bargaining power and could use the evidence of the benchmark remuneration during the negotiation process. Although not show in Table 1 the functioning of the remuneration committee recommended in order to assure to reliable and efficient shaping of the executive pay was also seen as a structural shortcoming failing to provide for independent and objective assessment of executives effort to corporate performance (Gillespie and Zweig, 2010).

3. Ethical dilemmas of executive compensation

Ethics is a branch of philosophy which provide a set of moral values (Duska, 2007) or principles of human conduct (Brickley et al., 2002). Ethics is a matter of ethos, participation in a community, a practice, a way of life (Hartman, 2005) including three fundamental principles: ethics of social utility, ethics of human rights and ethics of justice and fairness (Verma and Prakash, 2011). There is however "no consensus as to which behaviors are ethical and which are not" (Brickley et al., 2002) with the emphasis put on the impact and role of culture, social system and religion influencing the framework of understanding of ethics and morality. Research in ethics faces significant challenge since companies and organizations cannot be described as ethical or unethical as this feature related to individuals only (Doria et al., 2010). The discipline of ethics incurs also methodological challenges as the principles, the behavior evaluation and personal dedication and motivation can differ significantly depending on the individual and her or his context (Rossouw, 2009).

Business ethics remains one of the most debated themes in management and finance and is understood as "the application of everyday moral or ethical norms to business" (De George, 2010). However, the fundamental issue of room and need for ethics is not fully solved as the opinions range from the Peter Drucker's (1981 as quoted in Murthy 2007) declaration that "there is neither a separate ethics of business not is one needed" to highly dedicated statement emphasizing that "business ethics becomes a prerequisite for conducting any type of business, particularly in the global marketplace" (Azmi, 2006). Business ethics provides the underlying assumptions for corporate governance as the codes of best practice recommend honestly,

accountability and responsibility of operation of executives and directors and pursue equal treatment of shareholders although the ethical principles are not explicitly addressed in corporate governance documents or best practice codes. In line with the increasing awareness of company's role in social and economic systems and its, at least declared, dedication to mitigate its negative impact upon society and environment, the academic debate as well as business practice note the link between corporate governance and ethics (Llopis et al., 2007). The strong ethical values required from any executive and board director should assure for integrity and accountability which are viewed as the integral components of sound corporate governance and effective leadership (Erhard et al., 2010). Since corporate governance as the control and motivation structure shapes the operations and the behaviors of companies, investors and executives (OECD, 2004), the formulated set of rules should also address ethical dimension of the company operation referring to trust, equality, mutual respect, responsibility and long term orientation (Sternberg, 2000, Brickley et al., 2002). The convergence of values shared by corporate governance and business ethics should contribute to the development and strengthening of the organizational culture which implicitly and explicitly describes and shapes the corporate and employee behaviors explaining which activities are right and which are wrong (Nordberg, 2007; Koslowski, 2009). However, the pre-crisis practice of executive compensation as discussed in Table 1 raises several ethical dilemmas with respect to the remuneration size, structure and payout schemes and to principles such as honesty, accountability, justice and consistency. The main ethical dilemmas of executive pay are presented in Table 2.

Recommendation	**Ethical dilemmas**
Remuneration package structured into fixed pay and variable component	Motivation towards increased risk, more attractive package due to structural shortcomings
Bonus tied to performance	Instrumental approach to work and professional responsibilities – drop of the intrinsic motivation, increase of extrinsic motivation, spillover effects
Stock option and their value dependent on the company share price	Privileged treatment of executives, neglecting the contribution of other employees for corporate performance
Restricted shares	Privileged treatment of executives, taking advantage of the inefficient system
Increase pay size	Exaggerated size of the pay and growing gap between executives and other employees
Severance pay	Privileged treatment of executives, taking advantage of the inefficient system
Increased disclosure of executive pay	Strengthening of the position of executives

Table 2. Ethical dilemmas of executive pay characteristics. Source: own compilation.

 DOI 10.7172/1644-9584.46.6

As shown in Table 2 different the practice of executive compensation casts severe doubts on the ethical principles adopted within corporate governance structure (Johnson et al. 2010, Kirkpatrick 2009). This departure of top managers pay from the ethical standards is also perceived as a limitation of the motivational function and the overestimation of effects of the performance related pay. The remuneration structured into fixed salary and variable component which was perceived as an essential finding of corporate governance empirical analyses imposes some ethical dilemmas as the packages motivated executives to take more risk and increase the size of the package taking advantage of the structural shortcomings of the control system and inefficient work of remuneration committees (Bebchuk and Fried, 2004). The variable pay in the form of bonus tied to performance gave rise to the instrumental approach of executives towards their work and professional responsibilities. This increased the opportunistic behavior of executives and led to the drop of the intrinsic motivation, increase of the extrinsic motivation and resulted in negative spillover effects (drop in satisfaction with the job, excessive reliance of activity on external stimuli, transfer of extrinsic motivation to other areas, spillover effect, focus on stimulus related activities, multitasking effect). In result, executives paid less attention to their prime responsibilities while focusing on maximization of their pay. These effects are consistent with the psychological theories of motivation and undermine the fundamental assumption of executive remuneration structure (Rost and Osterloh, 2009). Although found in different industries throughout the economy such practice was particularly common in the case of the banking sector, mostly in trading activities in investment banks, known for its bonus culture (McGee, 2010). It promoted excessive risk-taking and shortermism which are believed to contribute to the outbreak of the financial crisis (House of Commons, 2009; Kirkpatrick, 2009). For instance in 2006 only James Cayne, the CEO and Chairman of Merril Lynch, received compensation of $33 million, of which $17 million was a cash bonus and a year later he was awarded $38 million while the bank went almost bankrupt and was taken over by JP Morgan. In both cases the significant proportion of the compensation was structured in the variable and short term component of bonus which amounted to 65%. The practical use of stock options as well as restricted shares, which were believed to tie the executive interests with those of shareholders revealed the privileged treatment of executives at the cost of other employees. The rise in pay perceived as an importance element to attract best executives led to the exaggerated size of the remuneration and the growing gap between executives and other employees. For instance the pay of Richard Fuld, Lehman Brothers CEO was estimated at of $34 million in 2007 when the bank made a loss and a drop in share price by 95%. More interestingly, Mr. Fuld earned $450 million over the period of 10 years increasing the gap between the CEO pay versus top four senior executive pay to reach the level of 250% in the year 2005–2007 (Nestor Advisors, 2009). The business ethics is not only questioning

the justification of such schemes but also addresses doubts to what extend one individual in able to exert impact on the corporate performance. Additional question would refer to the contribution of the rest of employees and their feeling of fairness and honesty. Moreover, the non financial component of the remuneration (the perks) was taken for granted and used at the costs of shareholders (Gillespie and Zweig, 2010). The good illustration is the debate over the purchase of new fleet of corporate jets in General Motors or the AIG directors who decided for the spa visit at the cost of $444,000 while the companies lost liquidity and were covered by TARP scheme. The practical adoption of the severance pay showed significant pathologies when executives were leaving the company and receiving generous package including additional services and benefits (e.g. members in the sport club). And finally, the postulated increased disclosure of executive pay led to strengthening of the position of executives and bargaining power during the negotiation process. The inefficiencies of executive compensation indicated also the shortcomings of remuneration committees which lack either the determination or responsibility to provide objective and independent assessment of executive performance and structure the pay respectively (Johnson et al., 2009; Bebchuk and Fried, 2004). The reasons lie as often in the information asymmetry as in the conflict of interest and limited independence and objectivity.

4. Directions for future

The outbreak and the course of the financial crisis as well as the public criticism of the executive pay observed throughout 2010 and 2011 reveal the significant understanding for the changes in executive compensation practice. More emphasis is put on implementation of high standards of both corporate governance and ethics into business operation what also results from the stakeholder expectations. The incorporation of ethics into business strategy and corporate governance is to create "an emotional and intellectual bond with a number of stakeholders and acts as the source of authority and credibility for all the company's dealings" (Verhezen, 2005). Business relationships are then built on trust and mutual respect (Sternberg, 2000; Boatright, 2005; White, 2006). The basic fundamentals of ethics to be adopted in corporate governance are as follows (Verma and Prakash, 2011):

- Transparency, disclosure and consistency,
- Respect and fairness in business service and treatment to the customers,
- Selflessness, integrity, objective, accountability, openness, honesty,
- Self-regulation.

In response to public criticism corporate practice showed significant changes with respect to the size, structure and regulations on executive compensation. A visible sign was given by the executives of European and American (UBS, RBS, Goldman Sachs) banks who either resign from 2010 or 2011 bonus or deferred its payout for a longer period of

 DOI 10.7172/1644-9584.46.6

time. Moreover, addressing the identified corporate governance weaknesses and irregularities of the executive pay as well as the ethical crisis of companies' practice, the researchers and regulators formulate the directions of further action pointing to the most relevant challenges. The significant reforms are brought by the implementation of new regulations – the Dodd-Frank Act of 2010, FRS and House of Commons recommendations, EU Green Paper on Corporate Governance and CRD III EU Directive. A set of new recommendations addressing both ethical controversies as well as corporate governance inefficiencies is listed in Table 3.

Reform assumptions	**Pay component**	**Ethical dimension**
Adequate pay structure providing incentive mechanisms for executives	Pay • calculated on profits and by reference to other business goals • using a measure of risk-adjusted return to take proper account of a range of risks including liquidity risk • the fixed component of the remuneration package large enough to meet the essential financial commitments • an appropriate mix of cash and components designed to encourage corporate citizenship and alignment of interests between those of the employee and the firm (e.g. shares/ stock options) • a major proportion of the bonus element is deferred and a significant proportion of the deferred compensation is determined by a performance measure calculated on a moving average over a period of several years	Adequate pay based on principles of fairness and honesty while assuring for creation of long term sustainable shareholder value and the incorporation of stakeholder expectations
Eliminating the risk of short term orientation of executives and excessive risk activities	Bonus calculation • risk or capital cost taken into account • performance to be assessed entirely on the results for the current financial year • adequate proportion of fixed component • bonuses not paid wholly in cash • deferral in the bonus element	Adequate pay based on principles of fairness and responsibility, relating bonus to performance
Eliminating the risk of short term orientation	Clawbacks	Adequate pay based on principles of fairness, accountability and transparency
Increased disclosure	Say on pay, presentation of the compensation policy	The pay based on principles of fairness, accountability and transparency

Table 3. Ethical dimensions for reforms of executive pay. Source: own compilation based on the Dodd-Frank Act of 2010, FRS and House of Commons recommendations, EU Green Paper on Corporate Governance and CRD III EU Directive.

The ethical dimensions of the executive pay refer to the increase of fairness as the remuneration should truly be related to performance. The reforms introduce the stronger link between the pay and the corporate performance measured by a wide range of financial and market indicators and stretched over a longer period of time. Under the severe public criticism the practice of executive compensation aimed at the elimination of the "guaranteed bonus." Moreover, the financial crisis saw in 2011 the unprecedented decrease of executive pay, mostly resulting from the decline of bonus estimated at 15–25% what is perceived as the most important change in the last 25 years. An efficient solution which follows the fundamental ethical principles is the adoption of the clawbacks – as research shows the number of companies pointing at the necessity of implementation of clawbacks increased to 64% in 2009 from 18% in 2006 (Hewitt Associates, 2009). Additionally, the size of severance pay dropped from 300% to 200% of the annual remuneration package. Finally, the adoption of "say on pay" rule provides the opportunity for shareholder to actively participate in the structuring of the executive remuneration and to present their opinions on the proposed compensation scheme. The "say on pay" rule also assures for higher transparency aiming at the disclosure of the compensation policy with respect to measures adopted with a company.

5. Conclusion

The corporate practice of executive compensation in recent years and particularly in the pre-crisis period gave rise to the significant concerns for both efficiency of corporate governance and ethical standards. The pre-crisis practice adopting generous packages characterized with short term cash bonus, extensive use of stock options, exaggerate severance pay and growing departure from average worker's pay departure cast severe doubt whether the form and content of executive pay truly plays its functions of motivation for increasing shareholder value. The pre-crisis remuneration packages faced severe criticism and are seen as an element which contributed to the outbreak of the financial crisis. The corporate governance inefficiencies are however less problematic than the ethical crisis depicted from the case studies of major corporations and financial institutions. The ethical controversies of executive compensation, the unlimited demand for pay rise, the aggressive bonus culture and short term orientation incur costs not only on the corporate performance but also on the underlying assumption of the role and importance business and finance in societies. The dangerous drop in intrinsic motivation and the increase of extrinsic drive for individual's behavior may destroy the very substance of human presence in organizations and responsibilities towards others. Such short term aggressive approach to business operation may in result prove to be detrimental for long term sustainable value for stakeholders. Thus from

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a certain point the financial crisis delivered a shake up and forced companies and regulations to implement new rules and principles for executive compensation. The recommendation on lowering the cash component, the extension of the evaluation period of executive performance, the proper relation between fixed and variable pay as well as introduction of the "say on pay" and clawbacks should improve both corporate governance standards and ethical principles of executive compensation.

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