

AGENDA

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Study: High Comp Consultant Fees Drive up CEO Pay

By Lindsay Frost July 6, 2020

A new study claims that consultants that rake in high fees reward CEOs with higher pay. The study concludes that consultants home in on repeat-business potential to recommend generous pay packages to CEOs; however, compensation committee members and several compensation consultants say the study lacks merit and does not account for independence, as evidenced by the board's role in oversight of pay to prevent this type of behavior.

This comes as investors are carefully scrutinizing CEO pay and are looking for more disclosure on compensation consultant fees, independence and the relationship with the compensation committee, citing a lack of **SEC** oversight on the issue.

Do Fees Correlate with Pay?

The study, "Compensation Consultant Fees and CEO Pay," found that if executive compensation consultant (EC) fees increase by \$1,770, which is a 1% increase of the average yearly EC fee, CEO total pay increases by \$4,474, which is 0.061% of the average CEO pay package. The study was published in the *Journal of Management Accounting Research*, a peer-reviewed publication of the **American Accounting Association**. The study looked at compensation consultant fees paid for compensation and non-compensation services disclosed at S&P 1500 companies between 2009 and 2014, which resulted in 952 compensation fee disclosures and 646 non-compensation-related fee disclosures.

"Considering that the change in CEO total compensation is almost three times larger than that of EC fees, the additional compensation that a client CEO could reap appears economically significant," the study concludes.

The authors looked at factors including revenue, sales growth and number of employees for the consulting firms, and total CEO pay, pay mix, CEO tenure, compensation committee size and independence for the S&P 1500 companies, among other factors. The study accounts for normalized EC fee increases, which include new CEO appointments, newly designed pay packages, and extra work such as market surveys.

This association between consultant fees and high CEO pay exists "only in weakly governed firms," write two co-authors of the study, **Jeong-Hoon Hyun**, assistant professor of the department of accounting, control and legal affairs at the **Neoma Business School** in France, and **Jeh-Hyuan Cho**, professor at **Arizona State University's** W.P. Carey School of Accountancy, in an e-mail.

The study points to the potential for repeat business as the driver behind these statistics, and not cross-selling opportunities to gain non-compensation consulting business, as originally hypothesized.

“The consultants receiving EC fees that are more than such expected levels ... are the ones that bias their advice and recommend higher CEO pay because they have more incentives to retain such profitable clients,” Hyun and Cho write. “[O]ur overall analyses suggest that consultants receiving higher EC fees may recommend overgenerous CEO pay to secure their business, and in return, such consultants are indeed more likely to be retained in the subsequent year.”

However, **Andy Goldstein**, managing director at **Willis Towers Watson**, says it is important to note that the study did not account for company size and revenue, only consultant firm size and revenue, which “calls into question the validity of the results.” He says larger, more complex organizations require more complex work from the consultant’s part, and thus higher fees.

Indeed, compensation consultants and a compensation committee member interviewed by *Agenda* largely refute the study’s findings, claiming inherent flaws due to the lack of fee data and proof of causation.

“The notion that consulting firms were charging more money and giving advice around higher CEO pay levels was illogical to me,” Goldstein says.

Georgia Nelson, a compensation committee chair at **Cummins, Inc.** and **Ball Corp.** and former chair of the human resources committee at **TransAlta**, writes in an e-mail that the study is “seriously flawed.”

She writes that although the study links consultant fees to CEO pay, she does not see proof of a correlation, and emphasizes the independent nature of consultants in relation to management. Although “much work is done together in the information gathering stages, the opinions and recommendations of the consultant should be entirely independent.

“I have not seen any indication that the pay of the CEO has any relationship with the fees charged. Fees are based on scope of work and hourly rates plus expenses in most all cases,” Nelson writes.

The study implies that tight CEO and consultant relationships also play a role, according to the co-authors.

“Compensation committees should be mindful of such issues that although longer consultant tenure can increase their expertise and efficiency, it can also aggravate conflicts of interest if the consultants develop ties and common interests with the CEOs,” Hyun and Cho write.

One compensation consultant from a large firm who asked not to be named tells *Agenda* that the study “reflects a completely naïve set of authors [with] no real-world knowledge or experience.”

The consultant says because the board hires compensation consultants, not management, if pay is higher than appropriate, “it results in pushback from investors who are given a vote each year to either accept or reject CEO pay.”

“If a company fails to secure a majority level of support, it reflects badly on the directors and the consultant is often fired,” the consultant says.

Similarly, Goldstein asks, “why would comp committees want higher CEO pay?”

If there are any inherent incentives or biases built into the system, it would “arguably be towards lower rather than higher pay,” the consultant says.

“Unjustifiably high pay creates risk of being fired, whereas low pay avoids embarrassment to directors and theoretically protects the consultant,” the consultant says. “The reality is that good consultants are [incentivized] to find the right balance, and this cannot be studied via statistics.”

Fees, Transparency and Committee Oversight

Currently, the SEC requires companies to disclose compensation consultant fees only if the firm provides more than \$120,000 of non-compensation-related services to the same company they provide compensation services to. That standard applies to few companies, sources say.

Consultant Fees Among Highest Paid CEOs

Few companies disclose fees paid to compensation consultants in proxy statements.
Here are the fees disclosed by those named on Equilar’s list of the 100 highest-paid CEOs in 2019.

Company	Consultant	Fees paid
Citigroup	Frederic W. Cook & Co.	\$328,133
Comcast Corp.	Hay Group	\$536,000
CVS Health Corp.	Exequity	\$331,588
Humana Inc.	Willis Towers Watson	\$283,900
Valero Energy Corp.	Exequity	\$516,374
Fidelity National Information Services	Mercer	\$246,121
T-Mobile US, Inc.	Mercer	\$362,000
Phillips 66	Mercer	\$245,519

Source: Equilar

Indeed, according to **Equilar**, only eight companies out of those listed in the firm’s [100 highest-paid CEO survey](#) disclosed compensation consultant fees for 2019, down from 11 companies that disclosed 2017 fees, [as reported by Agenda](#). These companies include **Citigroup**, **Comcast**, **CVS Health**, **Humana Inc.**, **Valero Energy Corp.**, **Fidelity National Information Services**, **T-Mobile** and **Phillips 66**.

“My firm ... has zero conflicts of interest that require disclosure in the clients’ proxy statement. So, every one of our clients that discloses our fees does so [voluntarily],” the anonymous compensation consultant says.

However, sources say more fee disclosure would be helpful to stakeholders. Goldstein says the disclosure of fees “ought to apply equally to all firms, not just in circumstances where firms are providing other services.”

“Simply having more numbers of fee disclosures can help mitigate [higher fees linked to higher CEO pay] because then there are more benchmarks to examine whether firms are paying

appropriate levels of ... fees,” Hyun and Cho write. “Compensation committees can also be more transparent about what kinds of specific services they retained from the consultants, allowing the readers to identify which services influence the change in ... fees.”

For example, **Rosanna Landis-Weaver**, program manager for Power Of The Proxy: Executive Compensation at **As You Sow**, which publishes a list of the highest-paid CEOs yearly, says the study “calls into question whether the SEC should be doing more broad disclosure, which would be a positive development.”

She says investors want more transparency on fees, and more pushback from compensation committees.

“It is supposed to be a balance of power, and it isn’t,” Landis-Weaver says. “Directors themselves are also paid quite generously, at the direction of consultants.”

Ultimately, it is the compensation committee’s job to evaluate consultants, including services, fees and performance.

“Compensation committees should make sure their independent compensation consultants are truly ‘independent’ from conflicts of interest,” Hyun and Cho write. “Retaining external consultants does not guarantee that their advice will always be objective. Our study shows that consultants with incentives to retain the clients that pay high fees may bias their advice and allow lucrative pay for the CEOs.”

Sources say fees do not play a big role in consultant evaluations. “It’s a relatively small cost for an organization relative to company size,” Goldstein says.

Generally, Nelson writes that written annual formal performance assessments for compensation consultants, and independence from management, are “imperative.”

“The approach I find most effective is a set of written expectations that are evaluated at the end of the contract year by the Compensation Committee, the management team directly working with the consultant and the CEO,” Nelson writes. “The evaluation culminates in a performance feedback session between the Compensation Comm[ittee] Chair and the principal consultant.”

Nelson writes that “the most important relationship factor between a compensation consultant and a committee is the level of trust in the consultant’s analysis, judgement and independence, and the consultant’s courage to voice their independence irrespective of management’s view.”

ADDENDUM

JULY 9, 2020

To the Editor:

My co-authors and I were gratified to have our research featured in *Agenda* ("Study: High Comp Consultant Fees Drive up CEO Pay," July 6), and reporter Lindsay Frost accurately presented our major findings. The story, however, included responses by compensation consultants that were anything but accurate. To cite just one example: Andy Goldstein of Willis Towers Watson

claims the study did not account for the size of client companies; yet, our analysis explicitly controls for number of employees and market value of equity of client firms, both key indicators of size. Indeed, it would be shocking if a peer-reviewed study overlooked something so elementary, as Mr. Goldstein claims was done, and this was the case with other objections made to our findings. *The Journal of Management Accounting Research*, in which our study appears, is rigorously peer-reviewed.

The principal finding of the study, based on extensive archival data, is that consultants are decreasingly likely to provide objective expertise when corporate governance is weak and consultants are faced with conflict of interest. These may be sensitive issues to certain individuals, but it is important to note that our results, supported by solid statistical analysis, point up weakness in the system, including disclosure regulation, and are not restricted to a specific firm or consultant.

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