Kent Business School

Working Paper Series

Building Societies' Demutualization and Managerial Private Interest

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KBS
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Working Paper No. 94
Jul 05

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The author is grateful to Prof. Krishna Paudyal for his continuous helpful suggestions and comments on this paper. I also want to thank to Discussant and other conference participants at The Inaugural International Conference on Business, Banking and Finance, 2004, April, Trinidad and Tobago. The usual disclaimer applies.

JEL Classification: G21
Keywords: Building societies, Demutualization, Compensation, Private Benefits

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Abstract

We examined the relation between corporate performance and executive compensation of converted and mutual building societies and determinants of compensation over the period. Several findings emerge. First, average compensation of chief executives of converted building societies increased three folds in seven years while their counter parts in mutual societies benefited only by a modest increase. Second, whilst there is no significant difference in the performance of these two groups, the executives of converted societies received significantly higher compensation. Their total benefit increased significantly after the conversion. Third, the study confirms a significant difference in the determinant of compensation in converted and mutual societies. Finally, neither the corporate performance nor the size explains the compensation received by the executives of converted societies. However, a positive relation between corporate performance and executives' compensation is observed in the cases of remaining mutual building societies. Overall, the possibility that the flotation of the mutual societies was inspired by the private interests of executives cannot be ruled out.

Building Societies' Demutualization and Managerial Private Interest

I. Introduction

The demutualization process involves considerable time and resources of the firms going public.[1] In spite of this, most of the large building societies that were owned by members, rather than shareholders, in the UK have changed their mutual status to publicly listed companies (plc). Shareholders' (i.e. owners') wealth maximising managers venture into such costly reorganisation process only if the anticipated gains from plc status outweigh the costs of conversion. However, due to agency reasons, it is also possible that the executives entrusted with managing the firm opt to go public only to enhance their own (managerial) private benefits. This alternative scenario is particularly possible in the context of building society conversion because the compensation to the senior executives of building societies in the UK have been perceived to be lower than the compensation received by comparable executives of publicly listed firms in banking industry. Although, such differences in compensation packages are usually attributed to the differences in corporate performance and agency relation a number of studies (for example, Aggarwal and Samwick (1999), Garvey and Milbourn (2003)) demonstrate that principle-agent model explains differences in executive compensation across firms. Therefore, it is important to understand who gained from conversions – owners, executives or both.

Following the conversion of Abbey National in 1989, ten building societies converted to public limited companies from mutual ownership. Whilst the major beneficiaries are expected to be the members (shareholders), these conversions are generally considered to have benefited the executives of the converted societies. For example, it has been claimed that the chief executive of the Cheltenham and Gloucester building society received share options worth £1.4 million when the Lloyds bank acquired the society (Financial Times, February 21, 1995). Similarly, Barnes and Ward (1999) report that the annual cost of Abbey National's directors increased from £1,164,000 in 1989 to £2,371,000 in 1995. The directors of Abbey National also profited considerably from share options on conversion. In the context of increasing concerns

[1] For example, the Halifax Building Society spent £153 million (equivalent to 27 per cent of post-tax profit) to go public from mutual society.

in both media and academic literature as to the increase in executive pay of converted building societies in the UK, this paper examines the relationship between the firm performance and CEO compensation (managerial private benefits). Central to these concerns have been the size of increase in the remuneration of CEOs (including share options). However, it is also possible that such increase in compensation was matched by improved firm performance.

Mutual organisations do not issue shares and hence their executives cannot receive share options. However, they may receive comparable compensation in other forms, for example, cash or enhanced salary or bonuses or some combination. It could also be argued that the compensation package offered is a function of efficiency and the performance of the CEOs. Therefore, it is possible that prior to the conversion the building societies had low performing managers who lacked sufficient skills while after the conversion high quality managers are appointed with higher compensation. Although, in reality only a handful of managers were changed and most of them were promoted internally. More objectively, if the observed increase in managerial compensation is due to the improvement in managerial quality then the performance of such firms should improve. To examine these issues we compare the relative performance and remuneration of mutual firms and converted societies (now banks) to assess the significance of the form of ownership in determining the remuneration package of CEOs. We also analyse the determinants of CEOs compensation for both mutual and converted building societies. Overall, examinations of these issues help in assessing whether the conversion was guided by the private interest of the senior executives or by the shareholders' wealth maximisation motive of the managers or a combination of both.

The rest of this paper is organised as follows. In Section 2, a brief review of different theories and empirical evidence of executive compensation is provided. Sample and model specifications are described in section 3. Section 4 presents the empirical results of the study and section 5 concludes the paper.

II. Theories of Managerial Compensation

Issues on managerial private interest, executive compensation and corporate performance have received considerable attention of academics and practitioners alike

in the recent past. Prior studies have identified many factors that are thought to be critical in determining executive compensation. In this section we summarise the major theories that are pertinent to the research objective identified in previous section of this study and develop testable propositions.

2.1 Corporate growth hypothesis:

Corporate growth approach (i.e. growth in size measured by either sales or assets) suggests that the size of the firms not the profitability has a significant effect on executive compensation. Literature has generally supported the corporate growth approach for the determination of executive compensation. For example, early managerial theorists (see Cosh (1975), found that company size determines the executives' compensation while Meek and Whittington (1975), document that growth pays no better than profitability. These two early studies of executive compensation generally support a positive association between compensation and size of the firm and growth of firm and compensation but not between compensation and profit. However, later studies included other potential variables, in addition to size, in the determinants of remuneration. For instance, Gregg et al (1993) investigated the relationship between the remuneration of the highest paid director and the economic performance over the 1980s and early 1990s and reported evidence of disappearing relationship between directors' pay and corporate performance. They concluded that corporate growth is an important determinant of the change in directors' remuneration. Ingham and Thompson (1995) examined the effects of size, growth, performance, and CEOs' age on managerial compensation and reported a weak association between the changes in performance and managerial compensation. They further note that growth is more influential than profit in determining the managerial compensation. Bliss and Rosen (2001) examined the effect of bank mergers on executive compensation and posit a link between firm size and CEO compensation and conclude that growth through any means is good for executive compensation. Gomez-Mejia and Wiseman (1997) report that CEO compensation is positively associated with firm size. Conyon (1998) reports that the link between company size and executives' compensation appears more robust than the association between pay and performance. Overall, the above discussion suggests testable propositions that: (a) "there is a positive relationship between size of firm and compensation".

2.2 Agency theory hypothesis:

In literature most attention on executive compensation has received from the perspective of agency theory. In agency theory, owners (shareholders) and the agents (managers) of the firm are different and they have conflicting interest. The principal-agent model of executive compensation suggests that by tying the pay of executives to firm performance such conflicting interest could be mitigated. Consequently, agency theory assumes that executive compensation will be positively related to firm performance. Despite the theoretical benefits much empirical evidence (see Gomez-Meija and Wiseman 1997 and Jensen and Murphy 1990) has found a weak link between compensation and firm performance.

Similarly Ogden and Watson (1996) examined the association between executive compensation and corporate performance after the privatisation of 10 water companies in England and Wales. They found that level of pay was driven by firm size and it has increased over the period of time. Firm performances were of minor importance in explaining the changes in the executives' pay. Wolfram (1998) also reports similar findings after examining the compensation received by the executives of 12 regional electricity distribution companies in the UK. Thus, a testable proposition emerges: "there is a positive relationship between firm performance and the level of executive compensation".

2.3 Ownership structure hypothesis:

It is also argued that form of ownership is important in the determination of executive pay. It will affect the ability and incentives of owners (shareholders) to monitor the manager. However, the findings are mixed. For example, Conyon and Leech (1994) have addressed the issue of company performance and ownership structure on remuneration. They report that corporate governance and ownership structure and control are not important in explaining the growth in top director pay in the mid 1980s. They found no evidence that the level of ownership concentration affects the growth in top director pay in their study period. However, Gomez-Mejia et al. (1997) report that firm's ownership structure significantly affects the pay of CEOs. They also posit that when there are dominant stockholders', CEO's compensation levels reflect their firm's performance and they are paid more for performance. They found this for both level and rate of change over time. Agarwal and Mandelkar (1990) examined

two competitive hypothesis, 'the active monitoring hypothesis' and 'passive voting hypothesis' and report that the existence of large shareholders leads to better monitoring managers. Their results support the 'active monitoring hypothesis'. They concluded that, as proposed by Shleifer and Vishny (1986) that the existence of large block holders leads to a better monitoring of the managers.

Following the ownership structure theory on determination of executive pay, it may be expected that mutual firms have less incentives or ability to monitor the managers' behaviour. Consequently, the link between firm performance and executive pay should be weaker for mutual forms and stronger for plc forms of ownership. We expect positive relationship between firm performance and level of compensation especially after conversion.

2.4 Social comparison hypothesis:

Social comparison theory, proposed by Festinger (1954), suggests that the executives' compensation is linked with the levels of compensation provided to other comparable firms. Generally, remuneration committees or other consulting firms determine the executive pay with reference to pay levels of similar type or size of the firm. Ezzamel and Watson (1996) argue that consultants base their recommendations on comparison with external market compensation and that may contribute to an increase in executive compensation. Executive pay is thus, not to be associated with factors such as performance, rather related to industry type and the size of the firm.

III. The Sample and Model Specification

3.1 Data:

In modern history of British financial system, the demutualization of mutual building societies started in 1989. Since then ten mutually owned building societies have been converted into limited liability companies in the UK. These companies cover more than 80 per cent of the total industry assets. In 1997 alone, five of the larger building societies (Alliance and Leicester, Halifax, Northern Rock, Bristol and West, and Woolwich), with more than 60 per cent of total industry assets, went public. This

study analyses the cases of four of these societies/banks.[2] Of the ten demutualized building societies, only six were independent conversions and the rest were either taken over by other institutions. National and provincial was acquired by Abbey National in 1995; Birmingham Midshires was taken over by Halifax in 1999. Similarly, Cheltenham and Gloucester was taken over by Lloyds TSB bank in 1995 while Bristol and West was acquired by the Bank of Ireland in 1997.

Our sample period covers 8 years between 1993 and 2000. We compare the CEO compensation packages of the sample demutualized firms (four) with that of 15 mutual building societies (control firms). These control firms have assets worth more than one billion Pound Sterling and necessary data are available. The main sources of data are Annual Reports and financial accounts of the sample and control firms. CEO compensation package includes six components. These are: annual salary, annual bonus, medium term bonus, long term incentive plans (LTIPs), value of employee share options (ESOs), and other benefits such as health insurance, and contributions for cars. All monetary items are expressed at the price of 2000, adjusted by annual Retail Price Index. Additionally, if a CEO is appointed during a particular financial year and detailed information on their remuneration is not available, following the approach suggested by Wolfram (1998), his/her salary is prorated.

Table 1 reveals that the average size (measured by total assets) of firms under analysis is £16,660 million while their sales revenue stands at £1,040 million per year per firm. It shows that every Pound Sterling invested in building societies' assets generate sales worth 6.2 pence. These statistics confirm a need to control for firm size in an analytical model. Table 1 further show that the average rate of return on assets (ROA) is only 5.94%. Table 1 further shows that during the sample period total assets of these firms grew by 10.23%, and their profit increased by 13.30% while average compensation received by CEOs increased by 11.72% implying that the compensation received by CEOs is not far way from the growth in assets and profits of building societies. However, the distribution of these measures reveals a wide variation in the growth rates of asset, profit and CEO compensation suggesting a further need to

[2] Bristol and West Building Society was taken over by a foreign bank and hence excluded from the analysis.

analyse whether these measures differ significantly between mutual and demutualized firms. We examine this issue in the next section.

3.2 Valuation of Executive incentive plans:

Two of the major components of executive compensation package are performance shares i.e. long-term incentive plans (LTIPs) and employee share options. Unlike other components of compensation they are not directly measurable. *Performance share plan (LTIPs)* is valued using equation (1):

(1) $\text{Value} = \text{price} * \text{shares} * \text{target} * (1/((1 + r + f)^{z}))$

Where, price represents the price at which shares/units were granted, shares is the numbers of shares/unit granted, target is the target payout expressed as portion of a share granted, r represents risk free rate of interest, f is the forfeiture risk and z is the length of performance period. This method is broadly similar to Westphal and Zajac (1994).

Data on price, performance shares granted and length of performance period are collected from annual reports and accounts. Risk free interest rate used in valuation is UK government gilt rate matching to the performance period of the shares granted. The forfeiture risk is 3% as suggested by Towers Perrin, UK. Most of the firms grant the performance shares relative to the total shareholders return (TSR) of a comparator peer group. Where such peer groups' information is available, we used %ile % ranking in comparator group. If such information is not available, we used 50%. This is the similar method used by consulting firm Towers Perrin, UK.[3]

The value of employee share option is estimated using a model first introduced by Noreen and Wolfson (1981) for the valuation of executive stock options. The model is based on the Black-Scholes' option-pricing model.[4] Like the Black-Scholes option pricing model it takes stock price, exercise price, risk-free interest rate, expected life of option, volatility, and dividend yield into account. We obtain stock prices from Hydra Data base and exercise prices from annual reports and accounts of sample

[3] The method was made available to the author by Towers Perrin.

companies. Risk free interest rate is the UK government's gilt rate matching the life of option. Expected life of the option is measured by the maximum period of option in which it can be exercised. Dividend yield is the expected annual dividend to be paid during the life of the option divided by the average market price of the stock. Finally, volatility is measured as the standard deviation (annual) of a stock's returns.

3.3 The models:

As stated earlier, the primary aim of this paper to examine whether the demutualization of building societies was guided by the managers' private interest or their endeavour in enhancing the shareholders' (members') wealth. In achieving this objective, we address two issues. First, we compare the compensation packages received by the executives of the demutualized societies before and after the event. We also compare the compensation received by the executives of demutualized firms with those of continuing mutual (control) firms. We test for the significance of difference in compensation packages using parametric (T-statistic) test. A significant difference would suggest either the demutualization was guided by the private interest of the executives or the performance of the firms has increased substantially to justify the increased compensation. Therefore, such results would warrant an evaluation of firm performance.

Second, it has been recognised that the remuneration package of executives is determined by a complex interaction of several firm specific and market-wide factors but univariate tests discussed above cannot control for such complex interaction. Presence of such complexity is recognised by the wide array of variables employed by studies dedicated in investigating the determinants of executive pay (see Gomez-Majia and Wiseman 1997 for a review of such studies). Based on the variables employed, the studies on executive compensation could be grouped into two categories viz. accounting and market performance. However, there is no consensus on which approach is more appropriate in explaining the cross-sectional as well as time series variation in the levels (and changes) of executive compensation. This study examines the association between accounting ratios and executive compensation. This selection is guided by the nature of our sample. Prior to

[4] See, Noreen and Wolfson (1981) for the stock option valuation model. Crawford et al (1997) provide

demutualization (the event under analysis) the firms were owned by members, shares were not issued, and hence their pre-demutualization market price is not available. Moreover, the control firms we use are still mutually owned. Therefore, market performance measures cannot be applied. The accounting performance measures we use include return on assets, asset growth, and profit growth. The literature also documents an association between executive pay and firm size (see, for instance, Ciscell and Carroll, 1980 and Wolfram, 1998). To account for the size effect we include firm size (total assets) as a 'control' variable in the model. We also control for the influence of time. Equation (2) is estimated to examine the relation between compensation and performance.

$$(2) \quad \ln(Com)_{j,t} = a_0 + a_1 \ln(FS)_{j,t} + \sum_{k=1}^{3} b_k (Perk)_{k,j,t} + \sum_{y=1}^{7} g_t Year_y + e_{jt}$$

Where ln(Com) is the natural log of total compensation received by the chief executive of company j (j = 4 for converting societies; and j=15 for mutual building societies) in year t (t = 8 for 1993-2000). ln (FS) stands for natural log of firm size measured by total assets. Perk the vector of performance measurement represents three (i.e. k=3) accounting measures of firm performance (return on assets, assets growth, and profit growth). 'Year' is the year specific (0, 1) dummy variable and e_{jt} is error term.

We estimate equation (2) on panel data. We also estimate equation (2) for various components of executive compensation. In order to examine the possible implications of demutualization on the determinants of compensation we estimate the equation for three different sample (sub-sample) periods for both demutualized and continuing building societies separately. The sample/sub-sample periods are (a) the overall sample period (1993-2000), (b) the pre-demutualization period (1993-1996), and (c) the post demutualization period (1997-2000).

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a spreadsheet macro to estimate the model.

IV. The Results

4.1 CEO compensation:

As noted earlier although the average compensation received by CEOs is not different from average growth in assets and profitability of the sample firms their dispersions are very high. Estimates in table 2 (panel A) show that average compensation of the CEOs of demutualized building societies has always been significantly higher than the compensation received by the CEOs of other building societies. For example, average compensation of the CEOs of demutualized societies in 1993 was £296,540 while it was £172,360 for mutual building societies. In 2000, the executives of demutualized firms received £1,166,250 (including the value of share option and performance share plans) in compensation while the CEOs of mutual building societies received only £284,600. This shows that during the 7 year period the remuneration of CEOs of demutualized firms increased by 293% while the CEOs of mutual societies benefited by 65% only. We also analyse the differences in compensation of converted and mutual societies before and after demutualization. The table reveals that before demutualization (1993-1996) difference in the compensation of the CEOs of converted and continuing mutual societies was 94% but it reached to 232% after demutualization (1997-2000). The differences are statistically significant for each year in the sample. Overall, although the compensation received by the CEOs of converted societies has always been higher than that received by the CEOs of continuing mutual societies, the gap has been increased over the years, especially after the flotation (see Figure 1).

Panel B provides details of average remuneration of CEOs of both converted and mutual societies by its components. The table shows that both salaries and bonuses of converted societies are higher than that of mutual building societies. However, the difference in the compensation of CEOs has increased substantially after the conversion even without including value of the shares and options. This confirms that incentive payment is significantly different between converted and remaining building societies. Before conversion, the CEOs of converted societies were receiving 21% of their compensation in the forms of incentives (such as bonuses) but after the conversion this ratio increased to 46%. During the same period the share of incentives in total compensation received by the CEOs of other mutual societies' increased from

6% to 17%. Overall, the estimates recorded in table 2 establish the fact that the CEOs of converted building societies have been receiving more remuneration than the CEOs of mutual societies and the gap is widening rapidly, especially after demutualization.

4.2 Corporate performance vs. CEO compensation:

The discussion above confirms that the compensation package enjoyed by the executives of the converted building societies is significantly higher than that of mutual building societies. Moreover, their compensation has increased significantly after the conversion. This implies that the conversion was guided by the private interests of the executives. However, it is possible that such higher and increased compensation is associated with their performance. For example, above discussion clearly showed that incentive payment (payment linked to performance of the firm) to the CEOs of converted societies has increased from one fifth of total compensation to nearly half of the total compensation in the form of incentive payment. We address this issue in this section.

Table 3 provides a comparative picture of corporate performance and compensation between converted and mutual building societies before and after the flotation. The estimates show that total assets and sales of both converted and mutual building societies have increased significantly after the event. However, the rate of return on assets (ROA) and growth rate of total assets of converted building societies did not change significantly. However, ROA of mutual societies declined significantly but the rate of their asset growth increased significantly. The changes in profit growth remain insignificant for both groups of sample firms. The table further shows that the converted building societies are significantly larger (measured by total assets and sales) than mutual societies and the ROA of converted societies is significantly higher than that of their mutual counter parts. On the other hand, the difference in their asset growth and profit growth are not statistically significant. These statistics question the justification for higher compensation received by the CEOs of converted building societies. The change in performance is not in line with the increased compensation. We also compare the yearly performance of these groups of societies (table not reported) and find that, except in 1999, their performances do not differ significantly. Overall, the CEOs of converted societies are paid significantly higher compensation compared to remaining societies but they are not displaying better performance.

Overall, the comparative analysis (cross-sectional as well as before and after the conversion) shows that the executives of converted building societies are receiving significantly higher compensation than their mutual sector counterparts and their compensation has increased significantly after the conversion. On the other hand, no measure of performance reveals any significant improvement. These results do not support the notion of 'higher compensation for better performance'. Therefore, this analysis suggests that the executives are the clear winners of the demutualization who benefited more than the member/shareholders of converted building societies. This implies possibly the conversion of mutual societies to plc was guided by the private interest of the executives.

4.3 What determines CEOs' compensation?

Although the evidence from univariate analysis is revealing, such method fails to allow for the interaction between various factors that determine executive compensation. It also does not identify the factors that are responsible for deciding the compensation packages. To identify the determinants of compensation we estimate equation (2) in its various forms. The results are in table 4.

The estimates for full sample period (column-1, table 4) reveal that total compensation (salary, bonuses, benefits, value of LTIPs and share options) received by the CEOs of these firms is a function of firm size. This supports the hypothesis of positive relationship between firm size and compensation as stated in earlier pages. However, it is not related to any measure of performance i.e. the coefficients of growth in profit, growth in assets, and return on assets remain statistically insignificant. This does not support the notation of positive relationship between firm performance and executive compensation. This result is not surprising and is in line with studies on the privatisation of electricity and water industries in the UK. For example, Wolfram (1998) report that the salary increase awarded to the CEOs of 12 regional electric companies after privatisation did not correspond with the size of the companies and that largest changes in the executive salaries occurred over time. Similarly, Ogden and Watson (1996) examined the executive pay and relative corporate performance of 10 privatised water companies of England and document evidence that salary level increased significantly over time independent of any

changes in firm size or performance within the water industry[5]. The estimate also reveal a significant positive impact of dummy variable that represents the status of building societies (1 if the society is converted, 0 otherwise) indicating that the executives of converted firms are receiving significantly higher compensation. To control for possible structural shift in the relation between executive compensation and its explanatory variables we introduce year dummies in the model (column-2, table 4). The coefficients of all year dummies are significant and positive. Moreover, once the effect of time (year) has been controlled for, the impact of return on assets (a measure of corporate performance) on executive compensation becomes statistically significant. Its positive sign confirms that the increase in return on assets leads to increase in executive compensation. The effect of firm size remains significant confirming that the executives of larger firms receive higher remuneration. The coefficient of determination (adjusted R-squared) shows that this model can explain over 4/5th (82.6%) of variation in executive compensation. The table further reveals that there is no substantial change in the role of the determinants of compensation before and after the conversion (columns 3 to 6, table 4).

To assess whether the determinants of the compensation of the CEOs of converted building societies and mutual societies differ and whether the relationship changed overtime, we reestimate equation (2) for each group of companies – converted and mutual. The estimates that are controlled for annual variation are presented in table 5. The results (column 1) reveal that total compensation of the CEOs of converted firms is not affected by any measure of corporate performance. Neither the size of the firm plays any significant role. This rejects the notion of pay for performance in the context of converted building societies. This is partly consistent with the findings of Ingham and Thompson (1993) that both performance measures (ROA and profit growth) have negative effect on compensation. It is also note worthy that the coefficients for time dummies for the year after conversion (1997 to 2000) are significant indicating that the conversion played an important role in determining the compensation of the CEOs of converted building societies. The possible reasons for the lack of relation between corporate performance and executive compensation

[5] Wolfram (1998) reports 230 to 280 percent increase and Ogden and Watson (1996) report an increase of 156 percent after privatisation of electricity and water industries in the UK. Both of these measures exclude the value of share options.

include changes of chief executives around the time of demutualization. Indeed, two chief executives were changed around the time of demutualization[6]. However, these changes were not new faces for the companies; they were working as directors within the company. Overall, these estimates does not support pay for performance. On the contrary, the estimates (column 2) show that the compensation received by the executives of mutual building societies is positively and significantly affected by all three measures of corporate performance (profit growth, asset growth, and ROA) and the size of the company. The explanatory power of model is also very respectable 78 per cent.

The table further shows that prior to demutualization the compensation of the CEOs of converted societies was not affected by any factor but ROA (column 3). Contrary to general expectation it had negative effect on executive compensation. However, after the conversion the situation even got worse. Now the firm size, return on assets, and asset growth all are significantly inversely related to compensation (column 5). This reconfirms that the compensation received by the CEOs of converted building societies is increasing while the performance of the firms is declining. On the other hand, the compensation received by the executives of mutual societies has always been positively affected by some measures of corporate performance and the size of the firm (columns 4 and 6). Thus, the results in table 5 confirm a significant difference in the determinants of converted and mutual societies. The CEOs of converted societies are receiving significantly higher compensation and the principle of 'pay for performance' does not hold.

V. Conclusions

This paper examines the relation between corporate performance and executive compensation of converted and mutual building societies and determinants of compensation over the period. It also analyses the changes in the compensation package of the demutualized building societies and compares the compensation received by the CEOs of converted societies with that of remaining mutual building societies. Several findings emerge. First, on average total compensation of chief executives of converted building societies increased three folds in seven years (1993 to 2000) while their counter parts in remaining mutual building societies benefited by

[6] Chief executives of Woolwich and Northern Rock were changed in 1996 and 1997 respectively.

an increase of 65%. Second, the executives of converted companies receive significantly higher compensation than the executives of remaining mutual building societies. Third, the overall benefit of the CEOs of converted firms increased significantly after the conversion. Fourth, the results confirm a significant difference in the determinants of compensation. Finally, neither any measure of corporate performance nor the size of the firm can explain the compensation received by the executives of converted societies. Contrary to the principle of 'pay for performance' some measures of corporate performance are inversely related to the compensation of the CEOs of converted firms. On the other hand, a positive relation between corporate performance and executives' salary is observed in the cases of remaining mutual building societies. Thus, the possibility that the executives of converted building societies were motivated by their own private interest rather than the interest of the members while going public cannot be ruled out. It deserves further research.

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Table 1
Descriptive Statistics

Summary statistics of the major variables used in the paper are presented. Total assets are measured for the group. Total sales are the total interest earned of a group. Return on assets is measured by earnings to total assets ratio; where earnings are defined as interest earned and other income after deducting management expenses but before interest payments, provisions to loan loss reserves and taxes. Asset growth is obtained by dividing the change in assets by previous year's total assets. Profit growth is measured by the dividing the change in profit before tax by previous year's growth in profit before tax. Total compensation includes salaries, bonuses, medium term bonuses, benefits and values of share options and long-term incentive plan (LTIPS). The sample covers 4 demutualized and 15 matching building societies for a period between 1993 and 2000.

Items	No. of observation	Average for the period	Minimum	Lower Quartile	Median	Upper Quartile	Maximum	Std deviation	Mean /std deviation
Total Assets £m	152	16660	634	1669.86	3676	17710.21	182520	31423.25	.530
Total Sales £m	152	1040	48	115.26	239	964.11	9387	1831.11	.131
Return on Assets (ROA)	152	5.94	4.24	5.40	5.95	6.49	7.65	.696	8.534
Assets growth	152	10.23	-31.24	6.61	10.38	13.18	37.79	6.895	1.484
Profit growth	152	13.30	-73.71	-2.54	9.27	24.57	341.46	37.559	.354
Total compensation (£'000)	152	311.71	69.73	163.85	227.85	340.48	1584	241.42	1.291

Table 2
Compensation of Chief Executives

Panel A: Average Compensation for Chief Executives in Converted and Mutual Building Societies

Year	CE from a Converted Building Society with Options and LTIPS (£'000)	CE from a Converted Building Society without Options and LTIPS (£'000)	CE from a Mutual Building Society (£'000)	T-test difference in mean **(column 1x3)**	T-test difference in mean **(column 2x3)**
Column	1	2	3	4	5
1993	296.54	296.54	172.36	4.079***	4.079***
	(38.52)	(38.52)	(56.89)		
1994	372.56	372.56	192	4.253***	4.253***
	(51.66)	(51.56)	(79.63)		
1995	394.21	394.21	212.76	4.114***	4.114***
	(45.56)	(45.56)	(83.75)		
1996	478.74	478.74	215.93	2.939*+	2.939*+
	(173.22)	(173.22)	(85.94)		
1997	718.06	599.31	237.17	2.763*+	4.423**+
	(344.13)	(155.15)	(101.42)		
1998	794.76	645.01	254.8	7.263***	5.002**
	(179.54)	(205.56)	(119.51)		
1999	761.92	579.93	260.21	5.438***	4.132***
	(226.93)	(79.54)	(146.97)		
2000	1166.25	710.25	284.6	5.041***+	5.358***
	(341.48)	(112.96)	(146.50)		
1993-1996	385.51	385.51	198.26	7.862***	7.862***
	(108.35)	(108.35)	(77.48)		
1997-2000	860.25	633.62	259.19	7.521***+	10.196***
	(312.79)	(140.59)	(127.83)		
1993-2000	622.88	509.57	228.73	6.593***+	8.574***+
	(333.44)	(176.44)	(109.61)		

*, ** and *** indicate significant at 10%, 5% and 1% respectively. + Following Levene tests inequality in variance is assumed.

Panel B: Components of CEO Compensation:

Averages of various components of CEO compensation of converted and mutual building societies are presented. The salary is the fixed compensation provided to the chief executive officer. Bonus and medium bonus are performance related pay and awarded in the form of cash. For converted societies bonuses include medium bonuses (when paid). LTIPs and options are also performance related pay and awarded in the form of shares.

	Converted Building Societies			**Mutual Building Societies**		
Year/Components	**1993-1996**	**1997-2000**	**1993-2000**	**1993-1996**	**1997-2000**	**1993-2000**
Salary (£000)	292.18	418.19	355.18	175.31	191.27	183.29
Bonus (£000)	87.42	196.07	141.74	14.19	45.88	30.03
Medium bonus	N/A	N/A	N/A	3.78	8.63	6.21
Benefits	5.92	19.36	12.64	4.98	13.41	9.20
LTIPs (£000)	N/A	84.75	42.38	N/A	N/A	N/A
Options (£000)	N/A	141.88	70.94	N/A	N/A	N/A
Total	385.51	860.24	622.88	198.26	259.19	228.73

Table 3

Firm Characteristics of Converted and Matching Building Societies: A comparison

For the definition of the variables please see table 1. *, ** and *** indicate significant at 10%, 5% and 1% respectively. + Following Levene tests inequality in variance is assumed. If this test is significant then the difference in the variances of two groups are significantly different and our sample do not meet the assumption of equal variance.

Year	Total Assets £m		Total Sales £m		ROA		Assets growth		Profit growth		Total compensation	
Column	1	2	3	4	5	6	7	8	9	10	11	12
	Converted	Mutual	Converted	Mutual	Converted	Mutual	Converted	Mutual	Converted	Mutual	Converted	Mutual
Mean 1993-96	43137	6127	2826	409	6.13	6.09	12.85	8.39	21.14	16.06	385.51	198.26
Mean 1997-00	61473	8182	3625	506	6.12	5.68	9.88	11.45	12.17	8.74	860.25	259.19
T test for mean differences	3.042***	3.167***	3.028***	3.352***	.017	3.313***	1.233	2.664**	1.427	1.043	5.737***+	3.158***+
Mean 1993-00	52305	7155	3226	457	6.12	5.89	11.37	9.92	16.66	12.40	622.88	228.73
T test for mean differences	5.064***+		5.712***+		1.717*		.895+		.569		6.593***+	

Table 4
Factors Affecting Executives' Compensation of Converted and Continuing Building Societies

See table 1 for the definitions of the variables. Society status is a dummy variable that takes the value of 1 for converted building societies and 0 for continuing building Societies. The dependent variable (Com) is the log of the total compensation (salary, bonuses, benefits, value of LTIPs and ESOs) received by the CEOs. The coefficients are obtained from equation (2). *, ** and *** indicate significant at 10%, 5% and 1% respectively.

$$(2)\quad \ln(Com)_{j,t} = a_0 + a_1 \ln(FS)_{j,t} + \sum_{k=1}^{3} b_k (Perk)_{k,j,t} + \sum_{y=1}^{7} g_t Year_y + e_{jt}$$

	Full Sample (1993-2000)		Pre-Demutualization (1993-1996)		Post-Demutualization (1997-2000)	
Columns ?	1	2	3	4	5	6
Constant	2.851	1.818	3.103	2.220	2.573	2.144
	(8.477)***	(4.852)***	(8.522)***	(5.170)***	(6.213)***	(4.215)***
Society status	.223	.224	.037	.024	.455	.430
	(2.668)***	(3.144)***	(.401)	(.292)	(4.302)***	(4.027)***
Log of Assets	.307	.293	.270	.270	.313	.313
	(12.919)***	(14.563)***	(10.600)***	(11.604)***	(10.473)***	(10.662)***
Profit Growth	.000	.001	.000	.001	.000	.001
	(-.193)	(1.081)	(.361)	(1.383)	(.221)	(.643)
Asset Growth	.002	.002	.003	.005	.002	.004
	(.575)	(.670)	(.748)	(1.246)	(.491)	(.815)
ROA	-.003	.131	-.010	.101	.050	.110
	(-.069)	(2.893)***	(-.233)	(1.896)*	(1.061)	(1.702)*
Year dummy						
1994		.178		.161		
		(2.140)**		(2.238)**		
1995		.228		.220		
		(2.818)***		(3.246)***		
1996		.397		.363		
		(4.006)***		(3.864)***		
1997		.444				
		(5.104)***				
1998		.413				-.019
		(5.129)***				(-.212)
1999		.551				.097
		(5.513)***				(1.118)
2000		.655				.203
		(7.142)***				(2.576)**
No of Observations	152	152	76	76	76	76
Adjusted R^2	.749	.826	.760	.802	.852	.862
F - stat	91.018	60.665	48.589	38.976	87.078	59.372
D-W stat.	1.695	2.010	2.152	2.095	2.111	2.173

Table 5

Comparison of Determinants of executives' Compensation before and after Demutualization

See table 1 for the definitions of the variables. The dependent variable (Com) is the log of the total compensation (salary, bonuses, benefits, value of LTIPs and ESOs) received by the CEOs. The coefficients are obtained from equation (2). T-statistics are in parentheses. *, ** and *** indicate significant at 10%, 5% and 1% respectively.

(2) $\ln(Com)_{j,t} = a_0 + a_1 \ln(FS)_{j,t} + \sum_{k=1}^{3} b_k (Perk)_{k,j,t} + \sum_{y=1}^{7} g_t Year_y + e_{jt}$

	Full Sample (1993-2000)		Pre-Demutualization (1993-1996)		Post-Demutualization (1997-2000)	
Columns ?	1	2	3	4	5	6
Societies ?	Converted	Mutual	Converted	Mutual	Converted	Mutual
Constant	6.873	1.937	7.763	1.844	21.803	2.327
	(3.268)***	(6.186)***	(4.059)***	(3.985)***	(3.680)***	(5.752)
Log of Assets	0.025	0.310	0.083	0.286	-0.741	0.333
	(0.259)	(18.666)***	(1.240)	(11.481)***	(-2.381)**	(14.752)***
Profit Growth	-0.001	0.001	-0.002	0.001	0.005	0.002
	(-0.475)	(2.207)**	(-0.719)	(1.361)	(1.436)	(1.862)*
Asset Growth	-0.008	0.008	-0.006	0.010	-0.039	0.006
	(-1.222)	(2.539)**	(-1.307)	(1.805)*	(-2.538)**	(1.772)*
ROA	-0.195	0.093	-0.410	0.136	-1.189	0.047
	(-1.084)	(2.375)**	(-1.934)*	(2.408)**	(-2.696)**	(0.836)
Year Dummy						
1994	0.116	0.134	-0.053	0.154		
	(0.524)	(1.834)*	(-0.297)	(1.916)*		
1995	0.214	0.205	0.083	0.207		
	(1.006)	(2.881)***	(0.522)	(2.736)***		
1996	0.126	0.312	-0.240	0.348		
	(0.398)	(3.601)***	(-0.724)	(3.442)***		
1997	0.662	0.293				
	(3.104)***	(3.758)***				
1998	0.967	0.265			1.198	-0.012
	(4.676)***	(3.711)***			(2.962)**	(-0.156)
1999	0.640	0.383			-0.240	0.055
	(2.318)**	(4.275)***			(-0.995)	(0.740)
2000	1.111	0.421			0.626	0.111
	(4.269)***	(5.176)***			(2.868)**	(1.678)*
No of Observations	32	120	16	60	16	60
Adjusted R^2	0.706	0.780	0.575	0.705	0.496	.808
F-stat	7.777	39.363	3.897	21.172	3.105	36.371
D-W stat	2.093	2.233	1.861	1.899	1.976	2.430

Figure 1
Average compensation of CEOs by type of firms