### Bankers’ Bonuses:  
The case for and against  
Ruth Bender

#### Steve Macaulay

We are going to look at the subject of bankers’ bonuses; now it is a subject that has caused a lot of heat and most people will probably have already made up their minds. But in a good, academic tradition, we are going to take a step back from this and have a look at both the case for and against.

If it were a court of law we would have two expert witnesses, but we have got two for the price of one here in Ruth Bender. Now, Ruth you can look at both sides of this, as somebody who has studied executive compensation. Let us look at the case for.

#### Ruth Bender

OK, well the case for – this came about because we got an urgent enquiry from a magazine one night, they had been let down by a contributor, could they have 700 words on why bankers’ bonuses were a good idea.

So this is the case for bankers’ bonuses. First of all, Steve, you have to understand there is no right answer to this. There is absolutely no reason why bankers should be paid a vast amount of money and the guy who collects my bins in the morning not paid a vast amount of money. Or put it another way, probably soldiers, engineers, nurses are more use to society, but society has chosen to give bankers a lot of money. So the first thing is there is no right answer.

But if you then start from where we are. Investment banking, in particular, is an industry where profits are incredibly volatile and in any business where profits are volatile it makes sense to have a bonus structure in so you can reward employees in the good years and you don’t have to pay so much in the bad years. That makes absolutely perfect sense. And then you take it a stage further and it is an industry where what individuals do actually matters; one individual making a good call can make a big difference to the bank’s profit. So again, it makes sense, if you like, to reward them with a bonus. That is reasonable.

#### Steve Macaulay

Now there has been a lot of vigorous discussion in the press, with pressure groups, with people speaking out very loudly against bankers’ bonuses – what is the case there?

#### Ruth Bender

Well, there are many cases there. If you just say I was talking about performance related pay and having it variable with profits, one of the problems we had with the bankers was you had all these individuals who were on a high level of pay and all of a sudden they couldn’t get bonuses, but you wanted to keep them because you were afraid they would go away, so what happened was they increased their salaries.

So if you then move back to a high bonus structure and high salaries, it does involve rather a lot of pay coming out. And then if you carry
on from that, two other arguments – the first one is that bonuses don’t work. There is a lot of research evidence that says that bonuses work if you are standing on an assembly line, doing piece work, making things and you don’t need to engage your mind. But when you are trying to incentivise creativity in a complex job, there is a lot of evidence that says you can’t.

And then, the other fundamental point is that we are all a little bit aggrieved about the financial crisis and there is an argument – strong argument – that says it was caused by bad banking and it does seem a little bit unconscionable that the same people who got us into this mess are now getting very large bonuses, whilst thousands and thousands and thousands of people are suffering a lot. I think it is only polite for them not to take too much of a bonus.

So there we are; two sides of an argument. Any final reflections?

Two things: the first one is I have written about in the Cranfield Magazine [Think: Cranfield March 2010] so it might be worth looking at it; and the second one is, I like a Billy Joel quote where he talks about the more you know about a subject, the more difficult it is to come down on either side – the song is Shades of Grey if you want to listen to it.

Ruth, thank you very much.