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Performance-based remunerations as a corporate governance problem:

The Case of Thomas Cook

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Introduction

- In May 2019, Thomas Cook issued a third profit warning in less than a year, citing discounting and higher fuel and hotel costs.

- In August 2019, Thomas Cook agreed the main terms of a £900 million rescue package that would have seen a Chinese company take over its tour operations and creditor banks and bondholders acquire its airline.

- In September 2019, Thomas Cook sought an additional £200 million to see the company through the winter season when business was slow. Nobody came forward with the money, ending a 176 year legacy.

Thomas Cook's financial report

- The company's group accounts for the year-end of 30 September 2018, contained a 194 page set of accounts.
- The accounts presented positive earnings several pages before losses were made clear.
- Only on page 118 that one sees the profit and loss, and not until page 122 that one sees the weak balance sheet.

- Thomas Cook was warned over its accounting method in 2018 by its auditor, Ernst & Young (EY).
- It was later revealed that the company reported pre-tax “underlying profits“ of £250 million in its 2018 financial statement, a figure which was reached after it wrote off £150 million in costs as “exceptional” and “one off”. Meanwhile its reported operating profit was just £97 million.
- EY claimed that it challenged the company’s decision and strongly urged Thomas Cook to be careful over what costs were declared exceptional in the future, yet it nevertheless signed off on the financial figures.
- In the aftermath of the scandal, the FRC announced that it will look at the audit of the company conducted by EY.

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Executives' remuneration as the problem

- Performance-based remunerations awarded to senior executives aim to reduce agency problem and costs.
- Yet in the case of Thomas Cook, the company used dubious accounting methods to make its profit appear larger to justify for their executives' bonus payments.
- Senior executives' remunerations often linked with company's financial performance.
- There are potential risks that executives will used various methods to inflate or fabricate financial data to make the company appear more profitable on paper (also see Enron in the early 2000s).

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Recommendations

- Corporate governance mechanisms or measures to regulate directors' remunerations more vigorously.
- In the US and Netherlands, there are statutory provisions that allow directors' remunerations to be clawed back in cases of misconduct.
- Is this something the UK can consider?