

Executive pay

1. Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned in the Green Paper would you support? Are there other options that should be considered?

There is evidence that the legislative changes to remuneration policy made three years ago are having some effect. The binding vote on remuneration policy every three years has for the majority of companies found assent. There is increasing disclosure of bonus measures albeit some of which were retrospective. The average annual pay increase for Chief Executives over the last three years has hovered around 2%. This is very similar to the average wage increase for all employees. Nonetheless the disparity between the pay of the executives and the employees according the ratios published in this paper has widened substantially with only a recent reduction in the last year.

The growth in executive pay is attributed to growth in annual bonus and the LTIPs. In respect of LTIPs much of this may stem from an increasing share price. The media is very outspoken on the issue of executive pay and it is difficult to assess objectively the concerns of the voting public. There is evidence that since 2008, there has been little increase in average earnings for the general population which is very different to executive pay. So it seems that the country's population are living in a different economic world to that of executives, rightly or wrongly.

There are financial techniques to link company performance and executive remuneration which are available to a Remuneration Committee to produce an ROI (Return on Investment). The outturn of these could be shared with shareholders if needed. Whilst the methodologies take a snapshot at a particular point in time they do give an indication of the ROI in executive remuneration.

The level of disparity between executive and employee remuneration is a matter of concern for the Government. It may be that this is one of the aggravations leading to the Brexit vote and potentially crystallises dissent with a tangible signal of a society perceived as inequitable. Nevertheless it is important to encourage commercial leaders to add value and gain returns, i.e. make money for themselves and others as part of developing a thriving economy. Where it becomes problematic is when stakeholders feel these returns are not fairly distributed.

The shareholder view and influence is definitely the best way to assess the fairness of corporate earnings against performance and financial returns. It is a shareholder decision if the Board are fairly paid. For this reason I support increasing their influence though latterly they have been much more vociferous about their expectations. If there is significant shareholder opposition 30-40% in the annual advisory vote on actual salary awards, there should be a binding vote on actual remuneration the next year. The flexibility to pull forward a review of

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remuneration policy with a binding vote once in the three year period could be very useful to respond to changing internal or external factors.

The scale and complexity of remuneration plans is a matter of concern particularly in the largest listed companies. Having said that I and many other Executives in my network do not find the plans difficult to understand. The shareholders need to be certain that this level of reward is required in order to meet the demands of the business plan. Transparent, clear, simple remuneration policies which incentivise and reward the Executives for individual and collective performance are the foundation of any remuneration strategy. It is for Boards with their shareholders to agree any maximum package. It is important not to demotivate the key business leaders at a time when the country really needs economic growth.

Anecdotal feedback comes to me through my network of business professionals, encompassing legal, HR, company secretariat, directors and entrepreneurs with comments about the scale and complexity of the remuneration. Some plans do allow for payment of many multiples of salary in incentive and reward schemes. It is for the shareholders to assess the value created linked to these payments.

2. Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay? Do you support any of the options mentioned? Are there other ideas that should be considered? Consultation

There should be much more encouragement of retail shareholders to vote through better communication led by Company Secretariat, for example use electronic voting and/or a follow up if no vote submitted. Nominee or proxy accounts to be required to 'pass back' the vote to their shareholders. Visibility of voting between private and institutional would also be interesting.

3. Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?

At Board level, the first responsibility for executive remuneration sits with the Chair of the Remuneration Committee which recommends the policy and awards to the Board for their approval, some of which may need shareholder approval at the AGM. If this goes awry for whatever reason and there is serious dissent from shareholders concerns about the remuneration policy and awards, then the ultimate sanction must be the resignation of the Remuneration Chair.

Normal practice for Remuneration Chairs is a regular dialogue two to three times a year on remuneration policy and plans with key shareholders as part of Board communication plans. In effect this forms a senior shareholder committee albeit informally. This activity could be formalised into a practice within the Corporate Governance Code. Separately there will be

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internal discussions which should involve the CEO, Executive Directors and both the HR and Reward Director.

The Remuneration Committee Chair is responsible for reviewing the performance links and alignment of total remuneration policy across the organisation from Executive Directors to the employees. This would involve close working with the CEO, HR and Reward Director. This practice could form part of the Corporate Governance Code. The alignment of total remuneration includes annual pay, any bonus, share plans, and benefits including pension, cars, etc.

Any new member to the Remuneration Committee should have an induction plan which will introduce them to the tools and techniques underpinning remuneration and introduce them to shareholders and key Executives if needed. It is advisable that any Chair of this Committee should have experience as a member to familiarise them with the history and any issues.

4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

A new pay ratio, based on annual pay only, for internal purposes is very helpful as it shows clearly any widening or narrowing of salary disparity. This is a matter for the Board and Executives. It is important that the context and reason for any changes are clarified. There is no reason why this should not be reported as part of the annual remuneration report with the proviso that that this ratio is not valid for any comparison between companies or sector. The classic definition is between the CEO and employee. There is merit in extending to the main senior management levels, four including the CEO, to review average annual pay against the differences in responsibility. This should be helpful when assessing the quality of any succession plans.

5. Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done without compromising commercial confidentiality? Do you support any of the options outlined in the Green Paper? Do you have any other suggestions?

The approach introduced four years ago seems to be working well.

6. How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives? Please give reasons for your answers.

The agreed clear principle which underpins any remuneration policy is that it should be linked to individual and collective performance. There is an opportunity to link the LTIP to strategic measures of the company business strategy and plan in preference to the more customary TSR

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and EPS. The share price elements of TSR can be influenced by market or economic factors either positively or negatively which are sometimes outside the control of the company. Internal measures should be much more under the control and influence of the Board.

The second alternative which I support is the use of restricted stock as there is clear alignment (the share price) across the shareholders, the company and the Executive Directors. It is a clear, simple and transparent approach. All stakeholders have a common interest in the value of the share price.

There is concern at the length of tenure of a CEO and Executive Directors as this is shortening to around three years in some companies. Stability at Board level is important so longer holding periods before vesting could be helpful. Shareholders can retain their holdings for long periods of time, ten plus years, so increasing the stock holding periods by executives does support greater alignment of interests. Longer holding periods of shares by executives will also encourage longer time periods for business strategy and planning purposes.

The other factor which supports the better alignment with the interests of quoted companies and shareholders is the requirement for executives to have a minimum shareholding in the company to the value of twice their gross salary. The shareholding could begin with a grant of restricted stock on internal appointment or external recruitment. Any bonus payment annually could be partly in restricted stock and cash. The longer term incentive could be an LTIP with bespoke strategic measures or restricted stock. Holding periods could up to five or seven years.

Similarly setting any maximum level of award, limiting remuneration, can cause talented people to leave a business for greater reward opportunities. What has proved effective as measures are the clauses for clawback. This allows an employer to obtain a repayment of any short term incentive when any results are restated or found to be erroneous.

Strengthening the employee, customer and wider stakeholder voice

7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

Many large companies already have consultative forums and meetings for each of these three stakeholder groups. It would be simpler to use these forums when the Board would like their views on a particular subject. Conversely the groups could raise issues to the Board when required.

There are executives responsible for HR, Marketing and Sales, and Distribution. To appoint NEDS responsible for these groups could compromise their independence and confuse their

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roles with that of the executives. A simpler approach would be for a NED to visit one or more stakeholder groups at least annually with the relevant senior executive and an agreed agenda to listen and share views on issues of mutual interest. The Board Member could then report back to the Board.

An Executive Committee has usually a representative from each operational and functional division so these three stakeholders are represented at this Committee yet not at the Board. At the Unitary Board in the listed companies the executive representation is usually only two or three executives typically the CEO, CFO and a Corporate Director. This could be a limiting factor in their influence. This limitation may be having an adverse consequence on the progression towards more diverse Boards.

I support that there should be sections in the annual report dedicated to the strategy, focus metrics and activities centred on employees, customers and suppliers. The quality of any communication is so important and crucial to obtain essential stakeholder support.

8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

The most important threshold relates the number of employees rather than the legal entity. Any responsible employer needs to know the views of their employees on key issues. At the same time they know the importance of engagement and how this can be a foundation of high productivity. The employees are often the best source of innovative ways to reduce costs, and increase margin or develop new products. Two hundred and fifty employees was used for gender reporting and consultation legislation so for consistency purposes this threshold could be maintained. I noted on the ACAS site recently that the 2004 Information and Consultation of Employees in companies began at fifty. Overall I believe that any need to strengthen the stakeholder voice is best left to the Board and executive committee.

For clarity I believe the Board and Executive set any agenda to listen to any views, for discussion, as information, or finally consultation between the company and stakeholder. In line with company policy in the majority of companies, pay is a private matter between the employer and employee, setting aside TU negotiated rates. Whilst Board remuneration is reported annually it should remain private until that point and excluded from any information or consultation.

9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

It is important that the burden of regulation is minimised to support entrepreneurialism. The attitude to change is important and compliance is high on the agenda of every well operated company. Legislation to force owners and directors to change often means that they fail to see and capture many benefits.

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Codes of Governance are helpful especially when coupled with successful case studies of finding and harnessing stakeholder feedback for mutual benefit. This will encourage open minded leaders to listen to their key stakeholders. Particularly if those companies more actively involved with shareholders achieve greater financial success.

Corporate governance in large, privately-held businesses

10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

The case of strengthening the governance framework of the UK's largest businesses is that this leads to the creation of sustainable, successful companies which are the bedrock of any economy. Good governance aligns the interests of the company, shareholders and other stakeholders. As a minimum a 'light touch' governance framework should include companies with a 1000 staff or more.

The risk is that if this is too burdensome then the entrepreneurial thrust may be dimmed, let's be careful not to stifle the entrepreneurial spirit!

11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

See above response to Question 10 above.

12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

To be effective a separate code is essential which should be led by an independent body other than the FRC, whose credibility rests in the premium listed sectors. The IOD, perhaps, should provide effective leadership for this sector as its brief is wider than the QCA or BCVA. It would be helpful if any code could be developed through consultation with the relevant companies.

Greater knowledge and understanding of Director Duties by incumbent Directors with more transparent reporting requirements may well improve standards of operation and governance.

A voluntary code, guidance and sanctions for failure to honour could be the best route forward. Considering sanctions to prevent stakeholder mistreatment or underfunded pension schemes in the event of excessive asset stripping could be worthwhile.

13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

Yes, please see response to Question 8

Other issues

14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

- a) *Continuing or accelerating the progress to more diverse Boards representative of the UK population may well bring about a change in attitudes to the issues outlined in this paper. There is strong pipeline building of successful companies with diverse Boards which demonstrates clearly that higher, sustainable results can be found in organisations with Boards who are more representative of the wider UK population.*

- b) *There are examples of companies in the US, UK and, Europe who have strong values and beliefs about the right way to conduct the operation of an organisation as a foundation to provide sustainable results and mutuality of benefits. The companies which spring to mind are Facebook, Microsoft, The Mars Group, John Lewis Partnership, Lego and Arup. I understand that many Scandinavian companies operate on these principles. There is an opportunity to encourage or lead others to build their business in a similar way.*

- c) *The stakeholder group could benefit from the inclusion of pension beneficiaries. The size of any pension deficit can rest on the methodologies for calculating the liabilities according to actuarial and accountancy compliance and the economy, bond or gilt rates. These liabilities can hamper mergers and the future of the organisation. Directors can with draw funds from companies which could help offset these liabilities and position themselves as secured creditors far higher than pension beneficiaries in the list of creditors for payment. Pensions are future pay and pension beneficiaries need to be treated as stakeholders and any deficit included in a funding plan. Should not the level of pension liabilities be a measure in the short term incentive plan of Executives?*

Footnote

These views were formulated through a discussion of ten to twelve professional people, comprising lawyers, company secretaries, company directors, human resources and reward specialists organised through Devonshire House Network. This is coupled to my experience as an Interim Global Reward Director based in the UK or Europe.