HM Thinking

STRATEGIES FOR NAVIGATING TODAY'S REMUNERATION LANDSCAPE

Changing Faces at the RemCo

Hedley May
LONDON | NEW YORK

Hedley May is a global executive search firm dedicated to finding exceptional talent to transform your executive leadership teams.

From our offices in London and New York, we exclusively specialize in the most senior corporate functional roles for the world’s leading organizations.

Introduction

The Daily Telegraph

15th June 2012

We tamed the union bosses, now let's tackle the barons of business.

Daily Mail

8th May 2012

Three cheers for the Shareholder Spring!

Almost a year on from the UK's 'Shareholder Spring', whether real or a media creation, executive remuneration remains a red-hot topic.

Last year's high-profile investor revolts over executive pay cost the chief executives of AstraZeneca, Aviva and Trinity Mirror their jobs. Despite public promises ahead of the AGM to cut CEO Bob Diamond's bonus, a third of shareholders still voted against Barclays' remuneration report, prompting one adviser to say, "Barclays' Remuneration Committee meetings will never be the same again".

The broader political backdrop, meanwhile, is becoming increasingly hostile, as Europe's politicians wade into the debate on quantum. The City has been shocked by European Union proposals to cap bankers' bonuses at twice their salary, while Swiss voters have overwhelmingly backed new tougher rules curbing executive pay. This stands in stark contrast to the US, where there is not the same moral backlash against high rewards for success.

Historically, UK companies could operate in a vacuum with regard to remuneration policy. But today they find themselves in a hostile environment, in which political pressure to rein in executive remuneration, shareholder demands for a fair deal and sensationalist media coverage are the norm. Designing simple and transparent remuneration policies that are acceptable to shareholders and aligned with the business strategy, is now the aim.

In this report we examine how companies are adapting to this new requirement in an adverse landscape. We do not focus on the quantum of executive pay, but instead analyse the skills that are now required of the key players involved – Remuneration Committee (RemCo) Chairs, Human Resources Directors (HRDs) and Reward Directors – and how these individuals engage with executive management and institutional shareholders. We also consider how companies can successfully navigate the less than favourable media and political landscape.

Methodology

In compiling this report, Hedley May conducted 36 interviews with Chairmen, RemCo Chairs, HRDs and Reward Directors.

In total, our interviews covered the perspectives of more than 40 FTSE 100 companies spanning a breadth of industries.

In addition, we spoke with leading institutional shareholders, remuneration consultants and a Trade Union Congress (TUC) representative.

Executive Summary

The current executive remuneration landscape requires high quality individuals with a more exceptional and specific skillset. They are in quite exposed positions, but for those who shine, there is potential for career advancement.

Our research shows the following:

- The RemCo Chair must be sufficiently tough to push back on both shareholders and executive management, whilst also having many of the skills associated with a diplomat. Having a strong understanding of the company is important, as is the ability to get into the detail.
- The HRD must be independent of the CEO and executive colleagues. The role requires the business understanding to align remuneration policy with strategy. Technical skills are now a prerequisite. The HRD must also have deep internal and external networks and therefore the rich perspectives required to properly shape the debate.
- The Reward Director has to be a broad business thinker, whilst still being the technical expert. Communication skills are paramount. Demand for the best Reward Directors is increasing and some of the most talented could progress to become HRDs.

Remuneration Consultants are recognised as an important part of the process.

- Provision of data is a key element of the Remuneration Consultants' service, but invariably they are being asked to go further and provide real judgement. The market perceives that there are only a handful of individuals who are able to provide sound and robust judgement.
- There is an on-going debate about whether the current environment demands two sets of advisers – one for the executive and one for the RemCo. The balance of opinion from our interviews is firmly in favour of the single adviser.

Engaging with institutional shareholders is a new discipline. There is some best practice emerging, but many companies need to go further to ensure that they have strong relationships in place.

- For those companies outside FTSE 30, engaging with institutional shareholders can be a challenge. When making a change or introducing a new remuneration policy, it is vital to ensure that there is plenty of time to properly consult.
- The RemCo Chair needs to lead the shareholder meetings and demonstrate a real grasp of the material. Some shareholders have strong views on who, alongside the RemCo Chair, should or should not attend the meetings.
- Building up more detailed information on key individuals within institutional shareholders, and their approach to remuneration, would be beneficial.

UK PLCs may be at a disadvantage when competing with the private sector for global talent. Succession planning and employer of choice programmes take on even greater significance as a result. Dedicating sufficient Board and executive time to ensure the company has the best strategies in place is a critical task.

The media holds real sway. Companies need to find methods for getting their side of the story across. Socia l media may be one such way. However, public companies may need to go further and create a body to establish common approaches to remuneration and represent their views to wider society.

The Remuneration Committee Chairman

A NEW BREED

> I always tend to put one of my best NEDs into the RemCo Chair role.
>
> *FTSE 100 Chairman*

The role of RemCo Chair is now viewed as the most challenging of the committee chair roles, surpassing the Audit Committee Chair, with perhaps its only equal being the Chair of the Risk Committee within a financial services company. The RemCo Chair of a large PLC is recognised by all our interviewees as being an incredibly tough and time-consuming role, to which considerable personal reputational risk is attached.

Historically, the picture was very different, with some of our interviewees describing it as "the soft option" of the committee chair roles. Former RemCo Chairs were portrayed by some as big-picture thinkers with charismatic personalities, who tended to rely on stature and presence to persuade investors of the merits of the proposed remuneration structure. Whilst some of these skills may be helpful, on their own they are no longer sufficient.

> I hold my ground and can be pretty surly when I'm not happy so I'm no pushover.
>
> *FTSE 100 RemCo Chair*

A tough diplomat

Today's RemCo Chair must be "tough" and independent – "it is certainly not a role for the fainthearted" was a common refrain from our interviewees. Toughness is needed to push back against both executives and shareholders, keeping a rein on executive expectations, while persuading shareholders that the management team is deserving of its rewards. Independence was regularly identified as an important attribute, as the RemCo Chair must be able to form a view and not be afraid to espouse it.

However, RemCo Chairs must counterbalance this tough independence with the silky smooth skills of a diplomat. Listening skills are important, as they must strive to understand other people's perspectives in order to form a rounded view. A number of Chairmen also highlighted the importance of high levels of emotional intelligence, equipping them with the ability to properly understand and evaluate the motivations of executives. Emotional intelligence also enables successful RemCo Chairs to build relationships with shareholders and establish the requisite trust.

> The ideal RemCo Chair would be Kofi Annan – the role requires great diplomacy and negotiation skills.
>
> *FTSE 100 Reward Director*

> RemCo Chairs have got to get to grips with the detail – they don't have to be 100% but they do need to be able to explain why the scheme is the best one.
>
> *Institutional Shareholder*

Big-picture thinking with a grasp of the detail

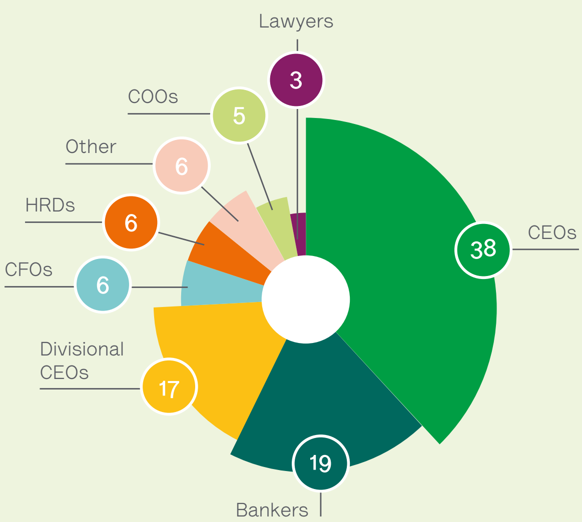
Setting remuneration policy is complex, requiring the design of a system that is aligned to and will support the execution of the PLC's strategy over three to five years. A thorough understanding of the strategy of the organisation and where the business creates value is essential. Whilst being highly business literate is a quality all NEDs should have, without it, a RemCo Chair will be particularly exposed.

This requirement for a strong understanding of the business makes it increasingly unlikely that a new NED will be appointed directly into the RemCo Chair role. A number of interviewees went further, believing it preferable for a RemCo Chair to have served time on that committee before ascending to the Chair role.

Whilst the bigger picture is important, being able to delve into the detail was also seen by many interviewees as an important attribute of an effective RemCo Chair.

A great deal of emphasis was placed on this by the institutional shareholders who, in drawing a comparison with Chairs of the past, explained that they are greatly reassured by a RemCo Chair who displays a strong grasp of the detail.

During the course of our research, we explored the extent to which a technical understanding of remuneration is necessary. This is particularly pertinent as some more recent RemCo Chair appointments are HRDs by background (see pie chart). However, all of our interviewees agreed that while technical skills are not a prerequisite, they could be advantageous. At the same time, the RemCo Chair has to be more than a layman and so must understand the current remuneration landscape and have a firm handle on "the art of the possible".



The Typical RemCo Chair

The typical RemCo Chair is a 60 year old man who has been a CEO. However, there is a wide range of backgrounds, illustrating that this is a role driven less by experience and more by skillset.

Male/Female: 82/18

Age Range: 41–78 (Median age of 60)

Serving Executives: 7 (4 are FTSE 100 CEOs)

> “Given the time commitment, the days of vast portfolios are over.
>
> *FTSE 250 RemCo Chair*

Not a role for the overstretched

Commenting on the now very weighty RemCo papers, all interviewees highlighted the significant increase in time commitment required. This is most acute in banking, where it is not uncommon for RemCo Chairs to spend a total of 80 days a year on the company's behalf.

The extra time is usually spent in pre-meetings and shareholder meetings. Outside of banking, a figure of around 40 days seems to be the norm, although clearly could be less if limited change is being proposed.

A Chairman in waiting?

Chairing the RemCo is no easy task. Whereas the Audit Committee is grounded in hard data and looks at the past, there is no "right answer" when it comes to remuneration and the focus is on the future. Furthermore, it is an emotive subject and there are often conflicting and strongly held opinions, with little middle ground. The ability to steer these meetings towards a conclusion is recognised as a special skill and for this reason a number of interviewees view the role of a RemCo Chair as a very good training ground for becoming a company Chairman.

HR Director

INDEPENDENT HEAVYWEIGHT

> “The effective and smooth running of RemCo is a principal part of the HRD’s responsibilities.
>
> *FTSE 100 Chairman*

> “You have to pass judgement on your boss and peers and they know that. It creates a distance between you.
>
> *FTSE 100 HRD*

Never before have HRDs had such a powerful opportunity to influence the Board, nor have they ever occupied such an exposed position. In today’s game of getting executive reward right, the stakes are much higher and alongside the RemCo Chair, the HRD is held accountable. However, leading the reward agenda is a good seat from which an HRD can gain exposure to the Board and increase their profile.

Independence is paramount

The traditional “shop steward” model of HRD has been largely discredited. The HRD’s role is not to maximise pay for the CEO and executive colleagues, but rather to reach a fair settlement for both shareholders and employees. An important and consistent finding from our interviews is that in all matters reward the HRD should be independent of the CEO and report to the RemCo Chair.

As the primary interface with the RemCo advisers, as well as the RemCo itself, HRDs are expected to give an objective view of the performance of their boss and peers. They must also be prepared, when appropriate, to disagree with the CEO. The HRD must walk a fine line between being seen as the independent conscience of the company and being supportive of colleagues on the executive team. Implicit within this is the ability to divorce their personal situation from any input they provide both to the CEO and to the RemCo.

> "A good HRD will be joined at the hip with the CEO but also independent... they sometimes have to go back to the CEO and say "you need to rethink" on an issue that is both very personal and emotional.
>
> *FTSE 100 RemCo Chair*

> "Five years ago you could get away with not knowing the technical detail, but not now. You have to know whether what you're designing is going to deliver what you need.
>
> *FTSE 100 HRD*

Never before have HRDs had such a powerful opportunity to influence the Board, nor have they ever occupied such an exposed position. In today's game of getting executive reward right, the stakes are much higher and alongside the RemCo Chair, the HRD is held accountable. However, leading the reward agenda is a good seat from which an HRD can gain exposure to the Board and increase their profile.

Technical expertise is no longer a 'nice to have'

Those ascending to the top HR role for the first time can no longer afford the luxury of learning the ropes on the job; they already need to be in command of the technicalities of reward and understand how the debate is moving. The trend, therefore, which is particularly clear in the financial services sector, is towards appointing HR leaders with significant reward experience.

Translator of strategy

Designing a five-year reward system and setting stretch performance metrics, which support the execution of the company's strategy, requires an HRD who has a clear understanding of that strategy and the ability to think long-term. The most impressive HRDs also align reward with talent management and succession planning.

Through reward discussions with the RemCo Chair and Company Chairman, HRDs have more opportunity than ever before to demonstrate the clarity of their thinking and make a strategic impact.

Consult, collaborate, communicate and corral

Such is the intensity and time-consuming nature of remuneration discussions, that the most credible HRDs will build very strong and effective working relationships with the RemCo Chair.

However, the HRD's relationships need to extend well beyond this. The most sophisticated HRDs proactively engage with a range of internal stakeholders in the Finance, Investor Relations and Corporate Communications teams, in addition to the NEDs, CEO and Company Chairman. This enables them to gather input and share proposals well in advance of committee meetings to ensure there is a well-informed and productive debate.

External insights

The importance of HRDs having a well-honed external perspective has also increased. This needs to encompass the global picture on talent, insights on how other companies are approaching remuneration and an understanding of the political and media dimensions.

It also requires an awareness of the positions taken by shareholders, unions and representative bodies and this is usually obtained through active networking. It is these insights that, amongst other things, equip the HRD with the information to deliver difficult messages to the CEO.

Our research, and the many interviews we have conducted in the course of our search work, indicates that most HRDs do not devote enough of their time to sharpening their external perspective.

> "The most successful companies have always been those which have been able to attract, develop, motivate and retain tomorrow's leaders.
>
> *Deborah Warburton*
> *Hedley May*

The Trend for HRDs to Become RemCo Chairs

> "There is nothing unique about [HRDs'] background, it is more that companies, for good reason, want women on their boards.
>
> *FTSE 250 RemCo Chair*

It is no coincidence that those HRDs who have impressed at RemCo are gaining Board appointments as NEDs. This was almost unheard of five years ago and, whilst partially reflecting the drive for greater gender diversity, also results from HRDs demonstrating a powerful Board impact through the quality of their thinking and communication around the reward debate.

Our research clearly demonstrates that HRDs' reward skills are in high demand for RemCo roles as the process and debate becomes more robust and rigorous. Of the seven HRDs (current and retired) who are FTSE 100 NEDs, six chair the RemCo and four are women. However, not all HRDs would be suited to being RemCo Chairs. Most of those interviewed believe that breadth of skills, including broad leadership qualities, financial acumen and independence of mind, are more critical than technical reward capabilities.

> "HRDs' are well-equipped to take on these roles, provided they are general business people.
>
> *FTSE 100 Chairman*

Six of the seven HRD NEDs also chair RemCo*

* of FTSE 100 Companies

The Rise of the Reward Director

> The Reward Director is to the HRD as the CFO is to the CEO.
>
> *FTSE 100 HRD*

> I couldn't live without my Head of Reward.
>
> *FTSE 100 HRD*

> There is just too much work not to have a Head of Reward.
>
> *FTSE 100 HRD*

From our interviews it is clear that the days of the "back office number cruncher" are past. Instead, there is the emergence of a new generation of reward professionals, who are more visible internally and have a broader business perspective. They are seen as "critical" by their companies and the standout individuals are even considered to be credible successors to HRDs.

The right-hand man of the HRD

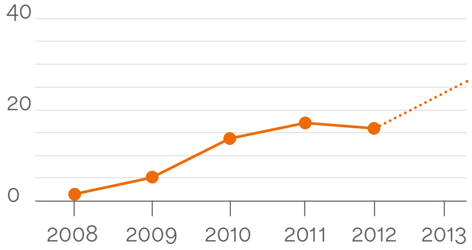
Reward Directors work "hand in glove with the HRD" and are now expected to have a similar skillset – independence, strategic awareness and influencing skills.

From back office to front of house

In the evolution of the Reward Director role, the biggest change has been the degree of strategic and business understanding that the job now requires. Reward professionals need a deep understanding of their company's underlying commercial drivers, requiring them to "get under the skin" of the business in a way that has not been expected of them in the past. Only then can they develop a reward framework firmly rooted in business strategy and effectively linked to performance, talent and succession planning.

> **Pay to get the best Reward Director you can – you will only pay more in adviser fees if you don't.**
>
> *FTSE 100 RemCo Chair*

% of new FTSE 100 Reward Director Appointments



Based on a population of 80 FTSE 100 companies

Indicates continuing tread

Communication skills have also become key. In developing reward proposals, Reward Directors must be able to test these with the executive and with RemCo. This necessitates the ability to engage at that level and also the ability to synthesise complex technical information for a relatively lay audience. Inevitably, there will be occasions when Reward Directors are asked to "push the envelope" more than is conscionable or wise in the context of the current landscape. At these moments, Reward Directors will need to demonstrate their independence and be sufficiently robust, without coming across as intransigent.

Technical skills and attention to detail, the traditional domain of the Reward Director, remain important. Devising creative solutions in order to attract and retain talent is still the primary purpose of the role. Arguably, this is more challenging within the constraints of the requirement for a more transparent and less complex compensation framework.

There has been a surge in demand for Reward Directors in recent years. With 10 companies either out in the market or having recently appointed candidates, we would expect 2013 to be the most active year yet for Reward Director hires.

You get what you pay for

Given the current environment, it is no surprise that talented Reward Directors are in high demand – since 2010 there have been 39 Reward Director appointments across the FTSE 100. The paucity of individuals who have this new skillset means that compensation for Reward Directors is on the rise. Increased scrutiny may not be good for the compensation of the executive team, but it is certainly proving to be beneficial for the Reward Director, who is now typically the highest paid of the HRD's reports.

Advisers

AN IMPORTANT PART OF THE PROCESS

“Remuneration consultants are unfairly damned.

FTSE 100 Chairman

“Benchmarks are valuable, but it is a data point, not a religion.

FTSE 100 Reward Director

“They should be able to answer the question, “Is this going to be a problem?”

FTSE 100 Reward Director

Remuneration Consultants have been subject to more than their fair share of criticism; however, in reality they are seen as an important and valuable resource for guiding companies and RemCos through a challenging landscape. The key lies in being an intelligent buyer – using the right people and instructing them in the right way.

The art of the possible

Some companies use their advisers purely for benchmark data, a view of the competitor landscape or an understanding of the latest thinking from BIS. However, increasingly companies are relying on them more heavily for judgement and requiring them to go beyond merely presenting the options.

These companies expect their consultants to work closely with the RemCo Chair and the HRD and to give bespoke advice and answer the question, “What would you do in my shoes?” The best advisers are prepared to offer a genuine view on what companies should do, rather than just what they could do, even if this means delivering an unpopular message.

> “I can count on the fingers of one hand those advisers who add value.
>
> *FTSE 100 Reward Director*

Informative insights

In order to truly advise, it is crucial that Remuneration Consultants fully understand the businesses they work with. Therefore, a number of interviewees pointed to the importance of companies investing time in building relationships with the key individuals in the adviser firm. However, it is also critical that companies ensure consultants maintain their independence.

Fundamentally, there are no shortcuts to great judgement, so it was not surprising that our interviewees identified just a handful of advisers that they particularly rate; they perceive a big gap between these top players and the next generation. As a result, the FTSE 100 seems highly dependent on a small number of ‘market names’, making access to the key person a challenge and raising the question of whether the adviser has sufficient time to devote to each individual business.

Of course, the benefit of this concentration of individuals is the exposure it gives them into what other companies are doing and perhaps most importantly, what shareholders have pushed back on and why.

The ongoing debate

The major question still being debated is whether companies should have two sets of advisers – one for the Board and one for the executive. Those in favour feel this gives institutional shareholders confidence that robust processes have been followed internally.

Certainly, the practice of Chairmen or RemCo Chairs bringing advisers from company to company with them is now frowned upon.

The majority of interviewees remain to be convinced that having two sets of advisers is necessary. Some see it as “a way for the executive to cover its back” and fear that it could lead to increased confrontation between the Board and the executive team. However, this debate is far from resolved and is likely to evolve over the coming months.

Engaging with Shareholders

A NEW DISCIPLINE

“ Companies are realising that they need to engage better – however, some are over-consulting.

Institutional Shareholder

If adverse headlines are to be avoided, the target for shareholder approval of the Directors’ Remuneration Report (DRR) is now 85%, not 51%. With such a high threshold, engaging with shareholders is a critical activity. It also extends beyond ‘shareholders’ to include Voting Advisory Bodies and Proxy Agencies such as ABI, ISS and RRev.

These bodies can influence up to 15% of the vote and, along with NAPF and PIRC, have a significant influence on media headlines in the run up to the AGM. How best to engage with shareholders and these wider bodies is far from straightforward and something that public companies are going to have to become more sophisticated at.

“ We wrote to our top 20 investors and only got a response from seven or eight.

FTSE 100 RemCo Chair

Engagement is not always reciprocal

The larger the PLC, the easier the task. For the FTSE 30, we gained a sense that they enjoy relatively easy access to institutional shareholders. However, for those outside this grouping, a much more challenging picture emerges.

The central problem is that many shareholders, by their own admission, are not equipped for this new level of engagement. Time constrained, they are therefore only interested in meeting when there is either a new remuneration plan being proposed or a change to an existing one. However, for RemCo Chairs and their team, persuading institutional shareholders of the merits of a potentially contentious plan, where little trust or relationship has been developed, is a very uncomfortable place to be.

> The days of a RemCo Chair being able to rely on the contribution of the consultants are over – this is something that goes down very badly.
>
> *Institutional Shareholder*

> If the HRD is at the meeting, that is not a particular problem, although the HRD and RemCo Chair do need to make sure they complement each other.
>
> *Institutional Shareholder*

> We are happy for the Company Secretary to be there too. They are more welcome than the HRD who is in the pocket of the CEO.
>
> *Institutional Shareholder*

A number of interviewees also drew attention to the fluidity of some of their hedge fund and other short-term investors that move in and out of the share register on a frequent basis. This makes any form of engagement very difficult and, even if you are successful, potentially pointless by the time the AGM is convened. However, the high hurdle for approval of the DRR means that the votes of these organisations could be very important.

A further challenge cited by our interviewees is that the institutional memory of shareholders can be short and there were instances recounted to us where the shareholder had forgotten why a particular arrangement had been put in place a few years previously. RemCo Chairs and HRDs expressed some frustration at having had to once again make the shareholder comfortable with plans that had already been agreed.

Strategies for engagement – a work in progress

Drawing together the best practice currently employed, the process begins with a letter to shareholders every year, offering a dialogue. For companies that are going to change their remuneration policy the message is to "go early" and properly consult, which means being prepared to make changes. The key is to avoid trying to convene a meeting with institutional shareholders in the run-up to the AGM season, their busiest time of year.

There was a significant divergence in opinion as to the ideal team for these meetings. Some companies regularly bring one or both of the HRD and external consultants to the meetings, while some interviewees felt very strongly that the HRD should never be present, arguing that this undermined the credibility of the RemCo. Some interviewees were equally concerned about the idea of remuneration consultants attending these meetings. Meanwhile, shareholders had similarly divergent views on the attendees, although all were adamant that they want the RemCo Chair to be leading the meeting and have a strong grasp of the proposals.

Account management approach

All of this left us with the impression that the current practice for engaging with shareholders is deeply unsatisfactory and somewhat weighted against the company. Clearly, the provision of greater resource from institutional shareholders would be welcomed, but this is not in the purview of the companies themselves.

A consistent message is that companies need to more proactively engage and build strong relationships with their shareholders. An approach akin to account management may be helpful. This might include building up a more detailed knowledge of the key individuals within the institutions responsible for deciding on whether to vote for or against the DRR, an understanding of their personal approach to remuneration, any particular 'red flag' issues for them and the extent to which they are influenced by the advisory bodies. In addition, a deeper understanding of their preferred meeting attendees and documentation, together with follow-up materials, would be beneficial.

This is an intensive project and should fall to the company rather than the already overworked RemCo, with the Company Secretary and Investor Relations team being the obvious choices. Once complete, it should be the start of the RemCos enjoying a much more comfortable dialogue with shareholders.

“We were left with an image of the country's leading business people huddled around a table, thrashing out remuneration issues, rather than engaged in how to develop new products or markets.

Nick Hedley
Hedley May

Succession Planning

THE MITIGATION STRATEGY FOR AN UNFAVOURABLE ENVIRONMENT

"In the US this issue is really not on the radar of politicians.

FTSE 100 RemCo Chair

"If this climate continues we won't get the best people into PLC roles.

FTSE 100 Chairman

The combination of an adverse political and media environment and high rates of personal taxation could leave UK PLCs at a disadvantage in the global marketplace for talent. Succession planning and employer of choice strategies take on heightened significance as a result. Institutional shareholders are also paying attention to these strategies as they are key to restraining pay inflation for executive directors.

A competitive disadvantage

The degree to which the UK is at a competitive disadvantage is difficult to evaluate. However, a number of interviewees were concerned about their company's attractiveness against multinationals and also the non-PLC employers, particularly, private equity firms. In some specific cases our interviewees provided examples of where they had elected not to hire their preferred candidate on account of the large package required and the political backlash and media headlines that might follow. In others, they had a very real fear that they would lose their CEO and not have the financial muscle to replace them with someone of equivalent ability.

The only strategy for counteracting this is for UK companies to put more emphasis on the combination of internal succession and becoming an employer of choice – internal succession being critical to identifying and developing the next generation of leaders and employer of choice branding to attract and retain the best. Successful strategies should equip companies with much, although not all, of the talent they require to compete globally.

> Succession planning is a critical issue and should be reviewed at main Board.
>
> *FTSE 100 Chairman*

> There is a lot of fear. The shareholder spring has left people feeling nervous about anything other than plain vanilla and keeping it low.
>
> *FTSE 100 RemCo Chair*

Proper evaluation of talent programmes

For Boards, having a clear line of sight on succession planning and the company's employment brand is an important task.

At present, it is common for the Nomination Committee (NomCom) to analyse succession planning for key executives and the Board to consider succession and talent for the whole organisation. In recognition of the close alignment between reward and succession, there is also a trend to ensure that there is an overlap of NEDs on both NomCom and RemCo.

Whilst Boards recognise talent and succession as important issues, many individuals have confessed that there is not enough time, both at executive and at Board level, currently devoted to these topics. The current environment means that they need to rise up the corporate agenda. For HRDs, this will increase the scrutiny of their work, whilst providing them with another platform to showcase their skills.

> Remuneration may be just one of many intrusions that companies can expect over the next few years.
>
> *Eleanor Hawkes*
> *Hedley May*

Media Management

GETTING ON THE FRONT FOOT

> In the US this issue is really not on the radar of politicians.
>
> *FTSE 100 RemCo Chair*

> If this climate continues we won't get the best people into PLC roles.
>
> *FTSE 100 Chairman*

Details of large pay packages sell newspapers and that is unlikely to change. The frustration for a number of interviewees is the misreporting of the story and the inability to defend their position. It is, of course, a common complaint about the media.

Whilst the growth of interactive social media makes it more difficult for a company to control its public image, it also offers the opportunity to engage more fully with stakeholders. One company explained that through Facebook it is able to communicate its message to 3 million 'friends', spreading quickly to an estimated audience of 28 million. Contrast this with the readership of the daily newspapers – The Times' circulation is currently circa 350,000.

Throughout our interviews there was a sense of fear induced by the media and this, together with the various initiatives from BIS, is creating a "state of paralysis". Pursuing a full and open dialogue with stakeholders through the modern media undoubtedly has a part to play in enabling companies to get their message across and be less beholden to misreporting.

A coordinated approach to debate and educate

However, companies should consider going further. Many adopt a low profile strategy and keep their fingers crossed that it "won't be their turn" to be "picked off" by the media. We wonder whether a collective and proactive approach is called for. Could a body representing the views of FTSE 100 and potentially all public company RemCos assist with ensuring there is a balanced debate played out in the public arena? Clearly, there are a number of challenges in creating a body that would be truly representative. However, assuming it can be achieved, in the rest of this section we outline some of the subjects such a body might consider.

> “The bottom line is we are vilifying business leaders. Genuine talent is exceptionally rare.
>
> *FTSE 100 HRD*

Broadly, the issues group into two sections: philosophies which underpin approaches to reward and educating the broadest range of stakeholders on public companies.

Philosophies which underpin approaches to reward.

To what extent does reward drive performance?

The link between reward and performance in business circles seems to be acknowledged, although there is disagreement as regards its relative importance compared to other performance levers in different sectors. However, some unions fundamentally dispute it and some academics are sceptical too. If FTSE 100 companies believe that reward does drive performance, what are the limits to this and are there sector differences which might impact the way particular companies remunerate their people?

To what extent does performance need to drive compensation?

There is recognition that there needs to be a fair deal between shareholders and executives. However, how closely should this be aligned – if the company does not perform, should no-one get a bonus? Are there any circumstances in which it is acceptable to reward failure?

Should there be a ceiling on quantum?

In the UK, much attention is placed on the quantum of pay and some view large executive reward packages as morally wrong. Is there room for morality in the debate about pay and, if so, how important is the social context of awards? Should there be a ceiling on quantum, either in absolute terms or as a maximum ratio between the highest paid and the median pay within an organisation?

> The health of the FTSE is more important than the man in the street understands and financial journalists do a poor job of educating them.
>
> *FTSE 250 RemCo Chair*

> There is a lack of appreciation about how difficult it is to deliver business success. The presumption is that there are hundreds off the street who could do that job but it is 24/7 in the hot seat and the media will not leave you alone. How many would want to do these CEO roles?
>
> *FTSE 100 RemCo Chair*

How rare is "rare talent"?

If the pool of top executive talent is truly limited – if there are only very few individuals who can run the largest companies effectively and highly profitably – then competition for the services of these scarce executives will drive up reward. If, however, talent can be more readily grown and nurtured, then the argument for the very highest reward packages becomes weaker.

Educating the broadest range of stakeholders on public companies.

Currently there appears to be a lack of understanding by the public of the direct link between the performance of FTSE 100 companies and value of pensions, savings and insurance assets. The long-term success of these companies is therefore very important to the welfare of the country as a whole. These companies are also major employers and some of the nation's largest exporters.

The same body might also consider detailing the challenge of being a top CEO. These are now typically complex global roles which demand exceptional time commitment and require individuals to sacrifice their personal and family life, as well as open themselves up to personal reputational risk. We question whether the wider public fully understands the extreme nature of these roles.

Welcome to the New World

The defining impression from our 36 interviews is the vast amount of resource and time that PLCs now dedicate to the question of remuneration. After each session, we were left with an image of the country's leading business people huddled around a table, thrashing out remuneration issues, rather than engaged in how to develop new products or markets. Whilst it would be very easy to condemn this as a waste of time, or as "the politics of envy", companies have to recognise that higher levels of scrutiny and increased transparency are here to stay.

The challenge lies in adapting to this new environment and for this a new style of RemCo Chair and a more skilled HRD and Reward Director are required. These individuals have a specific task when it comes to remuneration, but also have the opportunity to shape the way companies engage with not only institutional shareholders, but also wider stakeholders, such as politicians and the media.

Ultimately, big businesses have to acknowledge that there is a level of mistrust of their actions within society – remuneration may be just one of many intrusions that they can expect over the next few years. Getting on the front foot and developing a more active dialogue with stakeholders may not only have a positive impact on the remuneration debate, but might also save companies a significant amount of time and resource in addressing any future debates. If this is achieved then the time and energy of those involved in the RemCo today may prove to have been time well spent.

As for executive remuneration, it is only one tool and in and of itself has never guaranteed corporate success. The best companies have always been those which have been able to attract, develop, motivate and retain tomorrow's leaders. For a UK company today, this has never been a more critical task.

Hedley May
LONDON | NEW YORK

Previous Hedley May publications include:

- **Lawyers on Boards – "Where are they?"**
  in association with The Chairmen's Forum
- **Risk Upgrade: Rise of the New Model CRO in the Financial Services sector**
- **The Myth and Reality of the Corporate CRO – an individual or a set of capabilities?**
  in collaboration with Deloitte
- **Partner Lateral Hires: the critical factors that determine their success or failure**

If you would like further information on any of these subjects or about Hedley May, please contact Nick Hedley, Anthony May or Eleanor Sutton.

t. +44 (0) 20 7858 9444
e. eleanor@hedleymay.com
hedleymay.com

Hedley May

LONDON | NEW YORK

Sun Court, 66-67 Cornhill,
London, EC3V 3NB

hedleymay.com