MM & K, on 25 February 2008, held a dinner for clients, most of whom were Chairmen of companies, CEOs or Chairmen of Remuneration Committees. Over dinner, there was a discussion about:

Is Performance Related Pay *really* working?
How to make performance related pay achieve its objectives

Summary of Discussion

1. Different companies have different circumstances and need different forms of performance related pay. There is no simple solution which fits all companies at all times. Many people at the dinner have strong preferences on particular points. Many also held diametrically opposite views on some points. MM&K do not feel this is a contradiction or that some people are wrong. It reflects the truth that remuneration solutions are situational and there is no easy answer.
2. Be brave! Do not follow the standard approaches if your situation is not standard. Do not feel hidebound by the guidelines of the ABI, NAPF and institutional shareholders. The Combined Code is not a set of strict rules. Its essence is that you can choose to explain what you have done and why. In practice many companies do successfully explain their reasoning. MM & K recommends that if you have a solid case then you should be able to explain it to your shareholders - you will find that they will listen.
3. The US has got it seriously wrong on executive compensation. They have allowed bad practices to occur. They have allowed CEOs to have too much power and to set their own pay. Recent examples include backdated share options and huge payoffs to the CEOs of banks who have lost billions of shareholders' money. Going further back, uncontrolled excessive greed paid a major part in the disasters at Enron, WorldCom, Tyco, NYSE and Hollander to name just a few.
4. The UK is a role model for the world in terms of executive compensation (i.e. directors' remuneration). The requirements for disclosure, the constant pressure from shareholders and the advisory vote on the Remuneration Report are well ahead of other countries.
5. Most remuneration consultants (but not MM&K) give advice that strongly favours management. Remuneration Committees should appoint their own independent consultants. They should be wary of advice from consultants who also advise the management as this potentially conflicts with their ability to give independent advice.
6. Keep pay simple! Remuneration could be much simpler. Some consultants make it unnecessarily complex - so much so that in some cases not even the managers themselves really understand their pay.
7. Remuneration in Private Equity investment companies is simpler and more equity based. There is a higher risk of failure/downside. The pay deal is focused on the initial deal and subsequent liquidity events. Salaries are set at basic middle class existence levels (enough to pay the groceries and school fees). The amount of equity for managers is 10 to 20% of the total and the ordinary (sweet) equity will typically be highly leveraged. Equity gains are taxed at 10% (18% after 5 April) with no NIC for the company, which makes equity rewards much more attractive than cash. Managers are closely monitored by investors.
8. The contrast with a typical quoted UK plc is stark:-[Are we comparing pay in P/E investment companies (which is what 7 is about) or P/E backed companies with pay in listed companies? What point are we trying to make?]

Private Equity backed company	Quoted company
Pay structure is simple	Pay structure is complex - many plans
Equity is key component	Incentives through annual bonus and long term plans
Equity gains taxed at 10%	LTIP/ share option gains taxed as income at 40% +1% NI and 12.8% Employers NI
Salaries set at basic level	Salaries ratcheted up each year
Lower bonuses	Bonus opportunity typically 100% of salary - more in bigger companies - and trend is rising. Very few CEOs get nil bonus
Risk of failure/downside	Often generous severance terms and good pensions
Dilution of 10 to 20% and mainly front end loaded	ABI/NAPF guideline of 5% over 10 years = 0.5% p.a.
Highly leveraged	Modest debt /equity leverage
Managers closely monitored by investors	Most shareholders have small (<5%) stakes and need to build consensus over time before they can convey their view to Boards about management performance
Clear strategy and performance drivers	Very bland performance criteria, resulting in blunt instrument

9. People are crucial, not pay. Companies should focus on the individuals and work out what motivates them. They should not assume that pay is the only motivator. Whilst pay might be the predominant motivational tool in certain sectors of the economy (e.g. investment banking), in most organisations individuals come to work because they enjoy the work and their colleagues and the fun of working as a team to achieve something that is collectively worthwhile. In the latter, the paradigm is that managers will be fairly rewarded, whilst in the former there is much less organisational loyalty and employee motivation has to be bought through (expensive) incentive arrangements as ruthless (and expensive) hiring and firing is the norm, with zero tolerance of under performers.
10. There were three schools of thought on salaries:-
    i. You have to pay the going rate and you cannot expect good people to work for less than the going rate.
    ii. You only have to pay "middle-class standard of living" salaries (i.e. enough to pay mortgages, school fees and holidays). If you offer good bonuses and equity based incentives good people will find the total package attractive.
    iii. People stay because they like their job, the organisation and the culture and the sense of being part of doing something good (either collectively or individually). They do not look elsewhere for alternative employment unless one of the above starts to go wrong.
11. Star cultures. Football stars and pop-stars get paid huge amounts and few people object because their performance is easily recognised. CEOs and senior executives of large organisations can make a huge difference to the performance of their companies. Successful ones should be paid as stars.
12. Football coaches were cited as an interesting example. Many would accept the job for nothing as they love the game and they love the challenge. However they still set high demands for their pay and are able to get it.
13. Performance Related Pay did not add value to the NHS. A lot of time and money was spent on this with no identifiable benefits.
14. Companies should identify their business strategy, which people are needed to deliver it (including any new hires), how much pay is needed to keep them and how much extra they should get if they deliver the strategy and how much extra above that if they exceed the strategic goals.
15. Copycat remuneration plans that tick corporate governance boxes don't add value. Remuneration Committees need to consider carefully what is needed.

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