

Executive Reward: Is It Communicated Effectively?



Do Executives really understand their Reward?

Executive reward can be a prickly subject, hitting the headlines for all the wrong reasons. Even the Government is threatening a crackdown on excessive executive pay.

Yet how many executives fully understand the makeup of their reward packages let alone understand its true value or what drives this value? Not many I suspect!

Which begs the obvious question – why? Especially since most executives’ packages are worth many multiples of base salary and they will have built up significant value in their outstanding long-term incentives (LTIPs) which should be a great motivator and retention tool if only they understood it.

Despite a trend towards simplification, executive reward is still very complicated. The typical executive reward package has numerous moving parts, with a variety of performance measures and pay-outs spread over several years. It is continually changing, due to both internal and external pressures, which simply adds complexity as past changes can remain within the outstanding LTIP awards for up to 10 years.

Companies already issue numerous communications to executives throughout the year as part of the annual reward cycle – ranging from notification of their new annual salary through to their annual pension statement. These tend to concentrate on communicating facts and data rather than aiding understanding. Perhaps there are too many separate reward communications - a case of quantity rather than quality - making it time consuming for executives to get the full picture.

Technology is helping with online access to allow executives to see their reward data with links to external providers for summaries of their LTIPs and pension information. Some allow executives to make decisions on

their reward – for example to exercise their LTIPs or to change pension contributions and investment allocations.

Total Reward Statements are often used for employees to communicate the total value of the package, especially if this is part of a flexible benefits program. These tend to feed off payroll data, showing what has been paid, and rarely cover the complexities of executive reward let alone deal adequately with the performance related elements.

If executives are to truly understand and value their reward packages, a different approach is needed.

A bespoke, high quality executive reward statement that pulls all the relevant information together into one place would be a valuable addition to the suite of reward communications already issued.

So why don't companies issue a total reward statement specifically designed for executives?

Having rolled out executive reward statements for two global companies where I was reward director, I have direct experience of the challenges faced in undertaking such an exercise. They are many and varied, and no doubt companies will have their own reasons why they have chosen not to provide them. The box below highlights the main ones.

Why Don't More Companies Provide Executive Reward Statements	
Leadership	Board focused on strategy, design & quantum
Difficult	Executive reward is complex, many sources of data
Valuation	Assumptions needed for performance and share price growth
Messaging	Performance and value of package may have declined
Timing / Resource	Could impact on annual reward cycle processes
Cost	Bespoke exercise seen as expensive

Company Boards, Remuneration Committees and their professional advisers tend to focus on reward strategy, plan design and quantum. Implementation and communication is rarely given the same attention. Having the support of the Board would help ensure that the required budget and resources are allocated.

Producing bespoke executive reward statements is a notoriously difficult exercise, not least because of the complexity of executive reward and the number of decisions and assumptions that need to be made. Gaining agreement on design, assumptions and key messages can prove difficult and time consuming.

Executive reward data will likely be held in several different systems, including those outsourced to external

providers. This data needs to be extracted, validated and reconciled, which is rarely straightforward and can highlight anomalies which then need to be resolved.

The value of an executive’s reward can go down as well as up, due to the impact of performance reward. This throws up some interesting communication challenges, which some companies might prefer to avoid. Is it not better to tackle this head on, to ensure that the changes needed to improve future performance are made?

The company may not have the internal expertise or resources to manage the exercise.

Timing can be a problem, since the natural time to issue a statement is shortly after completion of the normal annual reward cycle to ensure the information is complete and up-to-date. This places additional strain on the internal reward team. Also, once the statements have been issued, someone will need to explain to the executives what they mean and answer any questions they may have.

Starting with a blank canvas has its attractions, but can make it difficult to get started. It may be easier to use an existing statement if this were available, provided that it could be tailored to the company’s needs.

A system is needed to manage the extracted data, carry out the numerous calculations, produce the various tables and graphs and pull all this together into a statement. This is likely to be an expensive exercise if such a system is built from scratch.

What would an Executive Reward Statement look like?

There is no set template for what an executive reward statement should look like. The box below summarises the key items that should be covered.

What Should an Executive Reward Statement Cover	
Last Year	What was earned last year
This Year	What could be earned this year
Past LTIPs	What is “in the bank” in terms of outstanding LTIPs
Timing	When the payments can be realised
Performance	How the value is affected by performance
Influence	Which plans and performance drivers have the most influence
Information	Summary of plans, performance conditions and current status

To provide executives with a full picture of their reward, the statement needs to show:

1. The value of each element that makes up the package
2. How this value varies under differing levels of performance; and
3. The timing of when the payments are made.

This could be achieved by evaluating:

- a) The reward for last year (backwards looking)
- b) The reward for this year (forwards looking)
- c) The value of all outstanding LTIPs (what’s in the “bank”)

The statement could also provide additional information on how the various plans work and the current status of the various performance conditions. It could even be used to replace some of the annual reward cycle communications to cut down on the number issued.

The way forward

Given all the above challenges, and despite the clear case for improving executive reward communications, is it really that surprising that so few companies produce bespoke executive reward statements?

However, if an executive reward strategy is to achieve its main purpose of “enabling the company to recruit, motivate and retain the highest calibre executives and to align their interests with those of the company and its shareholders”, it is essential that executives fully understand their packages. Having a well-designed reward strategy is not enough – it must be communicated effectively. High quality executive reward statements are a key part of this.

Companies may want to produce such statements in-house; some may prefer to use their reward consultants if this were a service they offered.

Whatever approach is taken, the main hurdles to be overcome are: the difficulties in just getting started; the cost of building a bespoke system to produce the statements; and having the expertise, experience and resources needed to see the project through.

With this in mind, we have spent the last two years developing a generic software system that can be used for any company, and have also produced a comprehensive example statement as a starting point from which to work. This removes the main barriers and should enable more companies to provide their executives with high quality Executive Reward Statements.



If you would like more information on our ERS System, please visit our website at www.GandCMiddleton.com.

Graham Middleton
 Director, G & C Middleton Ltd