

Letters to a new chair

Culture, values,
long term
sustainability
and purpose
have become key
cornerstones of
good governance.



The 'Letters to a new Chairman' (as they were then titled) were first developed by Hugh Parker and the IoD in 1990 and revisited by Tomorrow's Company in 2014. We argued then, as we still do – that good governance is a cornerstone of good business, and that the chair's role is pivotal in both.

Our first involvement with these letters was through our work leading the Good Governance Forum, which was established to develop practical tools and innovation, to help boards tackle behavioural and cultural challenges and open up new opportunities. Here, we have re-launched and refreshed them, in partnership with the KPMG Board Leadership Centre.

These letters look at how concepts such as culture, values, long-term sustainability and purpose have become key cornerstones of good governance. Similarly, board diversity in all its forms has become a necessity, not just the preserve of those forward thinking chairs. But how does the chair set the organisations purpose and character? What are the key relationships to work on? How do you exercise the right tone from the top? These are just some of the questions these letters seek to address.

The letters are not just for chairs. They celebrate and explore what makes for good governance; recognising that while the chair brings all of these people together, governance is a collaborative effort. This collaboration between executives and non-executives, supported by all members of the board, with all utilising the vital role of the company secretary, and through strong and effective engagement with and regard to the perspectives of investors and stakeholders. These themes come up time and time again in our conversations with directors about what makes good governance work for the organisation.

Governance is frequently held up as a solution to bad or unethical business. With every new scandal, we look to the boards of our largest companies and ask – how they could have let it happen? Barely a month goes by without outrage over an executive's pay or bonus, and the requirements and responsibilities of boards continue to increase. This is only right, and boards must see these changes as an opportunity to demonstrate fully how seriously they take their responsibility, and strive for better, moral behaviour that reflects their role as a vital part of the ecosystem. The companies that will do best are those that can see codes, regulations and reporting requirements as an opportunity, and think creatively about what governance is there to achieve and unlock, not that which it prevents.

The letters are also intended to spark debate. There has never been a one-size-fits-all model of governance and these aren't either. Instead, they are a starting point for putting good governance into practice.



Melanie Richards
Deputy Chair, KPMG UK



Dr. Scarlett Brown
Director of Research and Policy, Tomorrow's Company

Letter from a

Remuneration Committee Chair

**We
consult
rather
than
inform**

*Reputations can be
damaged where executive
pay is out of kilter with pay
and conditions elsewhere*

*The chair ensures that
the board enjoys the trust
of investors (and society)
in its ability to oversee
executive pay*

*The chair of the board
needs to ensure that
the committee sees
the big picture*

Dear Alex

I am not sure what advice I can offer that will give you comfort that senior executive remuneration will never turn into the disaster in the boardroom that it has in some large corporates over the last few years! Instead, I thought it may be helpful (and more constructive) to describe to you what life feels like as a chair of a remuneration committee when it works well.

There is of course no perfect remuneration committee, but I will try to describe some of the attributes of the best kinds through the remuneration committee of the fictional EA Blair Plc. Let's assume that EA Blair is a large listed company with a relatively low profile, it's been fairly successful in recent years but is facing a number of challenges in the current economic conditions. The remuneration committee has four members, plus the chair of the board. The members come from diverse backgrounds: I, the chair, am a former executive of a similar business, one of the members is a retired civil servant, another a former finance director and the last one is from overseas. The approach of the committee is to align the remuneration to the strategy. We draw the key performance indicators for the annual bonus directly from the strategic plan and the LTIP is structured to align pay and performance in the long-term. The salaries are set to be competitive, but not over generous. To the horror of some, we do look at benchmarks, but do not chase a perceived median and instead just use it as only one piece of data to inform our decisions.

Our decisions are not made only in the board room. Board members regularly visit Blair's operations around the world and we use these visits to talk to staff on the ground about pay and ratios as well as other matters. The remuneration committee also gets data about pay and conditions elsewhere in the group, and has a policy of setting pay rises for executives in line with those of employees. With pay ratio reporting now a legal requirement, this is even more important. EA Blair Plc isn't a household name, but the remuneration committee is aware of the reputational issues related to pay. It's not a regulated entity, but keeps abreast of developments as they often leak into the wider corporate arena. The committee is keen to adopt best practice reporting but we don't rush headlong into making changes without proper consideration and reflection. We do seek advice from remuneration consultants, who are chosen and instructed by us rather than by management (to reduce the risk of undue pressure). We look to such advisers for independent advice and an overview of the external landscape, but don't blindly follow this advice; rather we rigorously question what is put in front of us.

The remuneration committee has cross-membership with both the audit and risk committee and the nomination committee. This means we understand and are actively involved in issues such as succession planning, and ensuring our remuneration policy is in line with sound and effective risk management. As chair of the remuneration committee, I keep the board fully informed of the committee's deliberations after each meeting, the conclusions drawn and any recommendations to the board. The company secretary serves as the secretary to the committee. They provide support and advice on various matters and help with the drafting of the remuneration committee report, though ultimately I 'hold the pen'. The committee has a good relationship with the HR and finance departments, which provide timely information and analysis.

Letter from a Remuneration Committee Chair

The committee isn't overloaded with information, but we feel that we get all the information we need. Remuneration committee members read their papers beforehand and the focus of each meeting is on discussion and debate, not the presentation of information. I make sure that everyone gets a chance to participate in the discussions and the members are particularly good at seeing 'the wood from the trees'. The chief executive attends the remuneration committee to discuss their thoughts on the performance of the executive team, but never their own. The relationship with them is constructive, but the members guard their independence carefully. The chair of the board and I are acutely aware that we have a very good CEO, but that no CEO is indispensable. The committee reserves the right of discretion in all its plans and last year reduced the bonus for the chief executive, but increased it for the finance director. The use of discretion was highlighted in the remuneration report and explained, and most shareholders were supportive. The plans also include claw-back provisions, although thankfully there has not been cause to use them yet. When the remuneration committee decides to make changes (which is not very often) we consult, rather than inform the shareholders. A few years ago we had disagreements with some shareholders, but this was a constructive dialogue nonetheless. I emphasised that we believed they were acting in the best interests of the company and afterwards kept the lines of communication open.

Of course, EA Blair Plc, and its remuneration committee, doesn't exist, much as we might wish it! As executive remuneration continues to be scrutinised by the investor community and be an emotive issue in society, the utopian vision only gets harder to achieve. It is probably fair to say that in the eyes of wider society the legitimacy of UK business as a whole, as well as that of a number of individual companies, has been significantly damaged by pay packages that are out of kilter with pay and conditions elsewhere.

The remuneration committee faces a difficult challenge in responding to the global market for executive talent while ensuring that pay is clearly linked to performance and that increases are sustainable.

See the



This is very much a reputational issue and therefore a board issue. There is no one-size-fits-all approach to establishing the right rewards and, as we search for an answer, it is all too easy to focus on the structures of pay or seek 'the solution' in some new form of pay. However, experience has taught us that many of the solutions in the field of pay have either not worked or led to unintended consequences. In times of economic austerity, it is more important than ever that remuneration committees set challenging hurdles and rigorous processes for determining pay.

Whether or not you sit on your remuneration committee, as chair of the board you will need to ensure that the committee sees the big picture, to ensure that the whole board retains its 'license to operate' and enjoys the trust of investors. Ultimately, the answer to getting pay right must be in establishing an effective remuneration committee. So rather than look for the silver bullet solution – be that deferral, claw-back or new metrics – perhaps look to create a "Moon Under Water" remuneration committee.

Best of luck in your new role
George



big picture

