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parc

# REWARD MANIFESTO

## ACHIEVING CLARITY AND FOCUS IN TURBULENT TIMES

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# 1.0
# INTRODUCTION

There was a time when reputational risk at corporate level wasn’t something Reward professionals needed to lose much sleep over. Companies had Corporate Affairs’ teams, Risk Management experts, and Company Secretaries to worry about that sort of thing. Reward related horror stories were company specific and relatively unusual.

Nowadays, though, reputational risk is very much on the Reward professional’s agenda. Much of the adverse publicity, aimed at Corporate Head Office, centres on the level and structure of reward for senior executives and, even where it doesn’t, reward often comes as the follow-up punch to a story about something else. Even the recent wave of strikes in the UK has led to a focus on the remuneration of the executives running the companies affected. Reward might not always be the direct source of the reputational risk, but it is easy for it to become the source of attention when other things are perceived to be wrong. And during the pandemic, reward policy for senior executives was largely dependent on the approach adopted for the wider workforce.

Wider social concepts like Corporate Purpose and ‘Stakeholder Value’ (vs ‘Shareholder Value’) have become increasingly significant during the past decade, which has seen both a broadening and a deepening of the overall approach to corporate governance. International movements like ‘Black Lives Matter’ and ‘#MeToo’ sent shockwaves around the business world. Many companies have been blindsided by the expectation from customers and employees that they should have a clearly articulated policy on critical social issues of the day. With many companies having relied on government support of one kind or another during the Covid pandemic, the pressure on them to ‘do the right thing’ has never been greater. These pressures will only increase over the coming years as the environmental and cost-of-living pressures dominate headlines, and as the huge challenge of carbon net zero starts to hit company profits and government budgets.

The personal views of top executives need to be tempered against the pressures of societal movements and shareholder demands. They can no longer just think on their feet, giving their personal views in response to employee, shareholder, or media challenge.

This is not to say that companies should have an opinion on every social issue that makes the headlines. There will be some subjects which are clearly outside the scope of an organisation’s legitimate business interests. To adopt a position on such questions runs the risk of being seen as ‘virtue signalling’ or ‘jumping on the bandwagon’. It is, though, important for companies to realise that they are operating in a social context and that where once a throwaway comment by a senior executive might have gone unremarked, there is now greater scrutiny, and more is at stake.

PARC has adopted the term ‘Reward Manifesto’ to define those topics on which an organisation is most exposed to reputational risk. These are the critical areas where a company needs to develop a considered position – in each case outlining where it stands, and, as appropriate, what it will and will not tolerate.

Furthermore, the company’s position on these topics needs to be understood and endorsed by the Board, the CEO, personally, and their senior executive committee. The shared understanding brought about by this exercise is crucial to its value in managing and mitigating reputational risk.

As RemCo chair and former CEO Alan Giles pointed out:

> *“More often than not, difficult RemCo discussions are the result of not having had these in-principle agreements beforehand.”*

Gaining clarity on these questions up front can save a lot of time and potential embarrassment later.

The word ‘Manifesto’ comes from the Latin word for clarity. In an environment where challenge is the norm, gaining a shared clarity around the critical aspects of your organisational reward values, principles, and practices has never been more important.

This concept has been developed in conjunction with expert advice from a wide and representative set of those engaged in all aspects of Reward Strategy. Because of the sensitivity of the subject (which is a major theme in this paper) we have been unable to attribute some of the quotes, but the willingness of specific individuals to contribute to our research has been acknowledged.

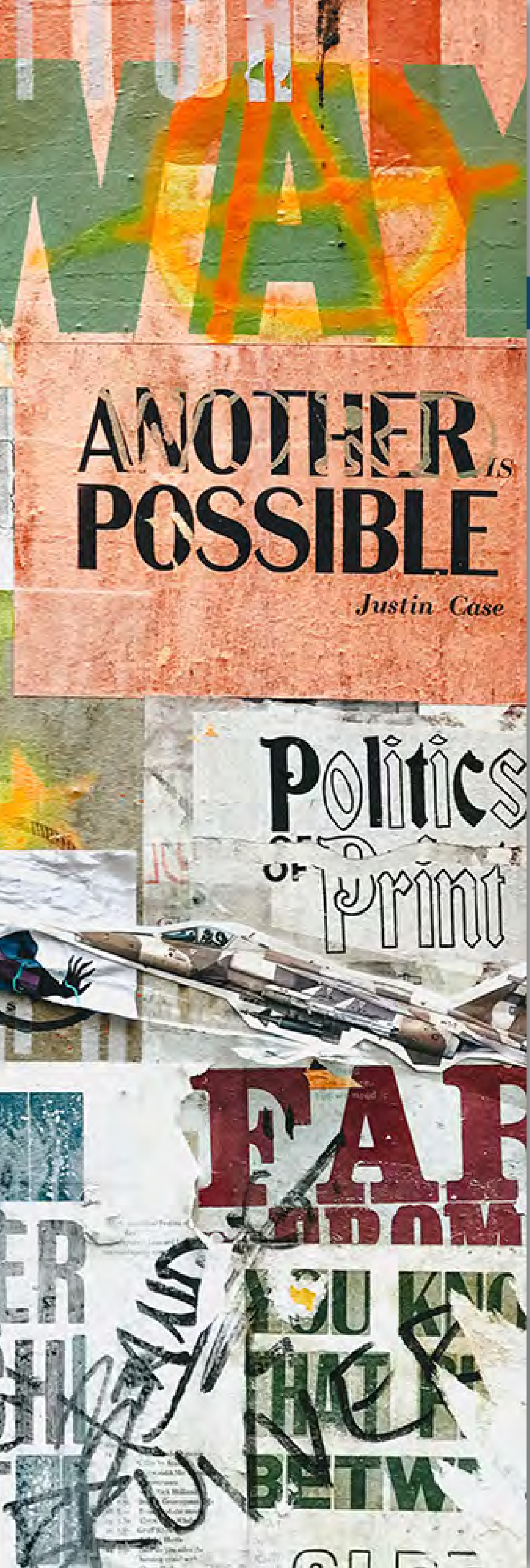
As social and economic pressures increase and, as variable pay forms an ever-greater proportion of reward, relying on technical expertise to develop reward policy will not be enough. Boards and their Committees need a sharp sensitivity to the shifting rules of the game and the invisible red lines beyond which their decisions cross the line of stakeholder acceptability.

**Section 2** will look at this changing context for reward policy during the coming decade. It will outline the social, economic, and political factors that impact on a strategic approach to Reward.

**Section 3** suggests a checklist of the topics – the subject matters that a Reward Manifesto might need to cover.

In **Section 4** we look in more detail at the specific issues – within each topic area – defined in terms of a set of questions that might need to be addressed.

Finally, **Section 5** draws the themes of the paper together and highlights the case for action.




# 2.0 THE CHANGING CONTEXT FOR REWARD IN THE 2020S

The context within which companies need to operate in the 2020s is already significantly different from that of previous decades. Social, economic and political forces that have been gathering pace for some time have come to a head in the early years of this decade. They have been reinforced by the fallout from recent events, notably the pandemic, the invasion of Ukraine, and the alarming increase in serious climate events.

It is worth examining some of these forces in greater detail in terms of their implications for companies' reputational risk and any resultant change in attitudes to Reward.

> *Anti-corporate rhetoric is now heard as much from the populist right as it is from the far left.*


## 2.1 CHANGING SOCIAL ATTITUDES

There is strong evidence of a general shift in social attitudes in most western countries. While it might be over-simplistic to say that people are becoming more liberal, the change in views on gender roles, racial discrimination, and same sex relationships are marked. This is not simply the result of one generation replacing another. Research by Ipsos MORI found significant evidence of attitudinal shifts in older age groups too. Something similar is happening with attitudes to climate change which, perhaps driven by extreme weather events, has shown a sharp rise in concern over the past decade and is now at record levels.

Public concerns about inequality are also rising. The Ipsos MORI Issues Index shows that, in January 2020, 22% of respondents rated it as the most important issue – and this rising concern is particularly marked among younger generations. The disproportionate consequences of the pandemic for those on lower incomes and its rapid re-ordering of employment and working patterns brought questions of fairness and equity to the forefront of public debate. This focus is likely to become more marked as inflation and the cost-of-living crisis start to hit household incomes over the coming winter.

## 2.2 RISING EXPECTATIONS OF COMPANIES

These changing social attitudes have had an impact on how people view companies and corporate behaviour. Public scrutiny of companies and expectations about their standards of behaviour increased markedly during the 2010s. Anti-corporate rhetoric is now heard as much from the populist right as it is from the far left. Even the UK's former prime minister was heard to use some choice language to dismiss the concerns of business. Criticising corporate behaviour is no longer the preserve of political activists. Customers, employees and potential recruits are just as quick to call out what they see to be unethical behaviour and to do so publicly on social media.

While, in previous decades, companies falling short of ethical standards might have run some risk of being punished by regulators, there is now a much greater risk of being punished by public and media reaction. A company is only one Twitter storm away from a damaging front-page headline.

As one RemCo chair put it:

> *"Increasing influence of social media hands great power to single issue proponents who are more able to call out companies on their particular obsession and gain traction remarkably quickly. It does not need to be shareholders contacting mainstream media. Your problems can spring from almost any direction."*

Younger workers, especially, are more likely to research a company's environmental credentials before agreeing to join as employees. Potential recruits from this age group are very alert to 'greenwashing' – statements by companies on their environmental credentials which have little to back them up.

## 2.3
## THE NEW CORPORATE ZEITGEIST

Former advocates of shareholder value and free market economics, such as Business Roundtable in the US and the Institute of Directors in the UK, are now talking about the redefinition of the company and the end of shareholder primacy. Blackrock CEO Larry Fink famously spoke of *"a fundamental reshaping of finance"* and *"the importance of serving stakeholders and embracing purpose"*.

There has been both a broadening and a deepening of the concept of corporate governance. Directors and investors are now being held responsible not only for the financial performance of the company but also for ensuring that it is run with broader ESG interests in mind. As Gillian Tett argued in the FT:

> *"The rise of ESG reflects a much bigger zeitgeist shift than anything captured by mere acronyms or box ticking. In the latter half of the 20th century, business and finance tended to analyse the world just with narrowly defined balance sheets and economic models – and treat social and environment issues as mere 'externalities' or 'footnotes'.*
>
> *"Today, companies and investors think that it is dangerous to ignore those externalities, be that medical risks, social trends, climate change, or the ethical problems around war. Moreover, new digital tools are promoting scrutiny by consumers and investors. This means that the social context of business matters – and investors ignore this at their peril. Hence the focus on stakeholders, not (just) shareholders; and the fact that so many businesses pulled out of Russia, so fast."*


## 2.4
## THE ECONOMICS OF OUTRAGE

Public concern about inequality doesn't appear to have been driven by actual increases in inequality – or, if so, the reaction has been somewhat delayed. The sharp increase in inequality in the UK occurred in the 1980s and early 1990s, but the public and media focus on executive pay became more intense after the 2008 financial crisis. In the 16 years since the crash, by whatever measure we use, inequality has flatlined or fallen. As the Institute for Fiscal Studies noted, the Top 1 percent and Top 0.1 percent now have a lower share of overall income than they did before 2008. Indeed, there is some evidence that the greater degree of restraint in the UK, driven by investors during the period of government Covid support, has resulted in some compression of differentials at the more senior levels.

It is likely, therefore, that the focus on inequality is driven by wider stagnating or falling living standards, rather than by the inequality itself. When people feel worse off, inequality becomes big news. As Mercer's Peter Boreham remarked:

> *"Fewer people worried about executive pay when everybody's living standards were rising. In 2008 the music stopped! Bankers' bonuses and senior pay became a focus of outrage. This was a major reset for reward. It introduced a new concept of fairness. Fair pay for senior executives became seen as being relative to the rest of the workforce."*

As one of the RemCo chairs we spoke to observed, after 2008, the criticism of executive pay became generalised, rather than being specific to single companies or sectors:

> *"Before the financial crisis, most remuneration stories were about an individual company that had strayed beyond the norm. Typically it would have paid in circumstances that were considered inappropriate by shareholders and it became newsworthy when shareholders talked to the press.*
>
> *"In 2008 opprobrium fell on a major sector of the corporate world. This sowed the seed not only for condemnation of the financial services sector but over the following decade more of the wider corporate world became fair game on many issues and a greater negative sentiment applied."*

Economist Duncan Weldon signals that there may be a sharper focus on inequality and high executive pay as the cost-of-living crisis starts to bite. Data released by the Office for National Statistics in August 2022 found that, over the previous year, average real terms pay had fallen at its fastest rate since records began. The impact was unevenly spread though, and as IFS director Paul Johnson remarked: *"Only the Top 1 percent of earners saw their pay keep pace with inflation."*

The ONS pointed out that, in the year to July 2022, pay increased the fastest in those areas that were already highly paid, such as financial services. A number of studies have found that pay inequality is driven more by the growing gap in earnings between sectors than by differences in pay within companies. The recent ONS data suggests that this gap will continue to widen. It is also likely that the resentment fuelled by this widening gap will focus on CEOs who, as the IFS says, are only a very small part of the picture.

Nevertheless, while pay among many professional groups may be high and that of those outside the quoted company sector is not readily discernible, the focus of this report is on the senior management of public listed companies. That is the arena where executive pay is clearly visible, where the names and access points are often also easily reached and therefore where the greatest reputational risk is likely.


## 2.5
## ECONOMIC OUTLOOK

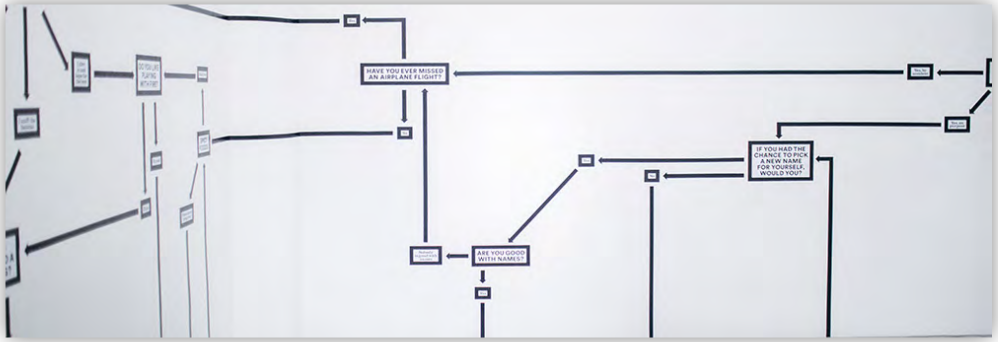
The war in Ukraine has further disrupted the global economy, and has fuelled the pressures on inflation and world trade that were becoming apparent after the Covid pandemic. Forecasts by the OECD, the Bank of England and the IMF indicate a long period of very low GDP growth.

Low GDP growth means low tax revenues. The likelihood of tighter monetary policies will provide governments with little room to manoeuvre. Any government action to mitigate the impact of the cost-of-living crisis is therefore likely to be limited. Low growth and high inflation will have a negative impact on company profits and on living standards.

The effects of these economic headwinds will be compound and cumulative. Most forecasts indicate that average incomes and living standards will continue to stagnate or fall. All of which is likely to sharpen the focus on executive pay as the public exemplar of differentials.








## 2.6
## THE IMPLICATIONS FOR REWARD VALUES, PRINCIPLES, AND STRATEGY

Companies have entered a prolonged period during which there will an even sharper focus on executive pay and the values and principles that underpin it. The economic outlook together with the changing social attitudes discussed above mean that executive reward will continue to be the subject of critical political, media, and public attention.

Changing social attitudes are influencing investor behaviour and, in some countries will drive further legislation on pay. In the UK, companies are already required to report their gender pay gaps and the ratio between CEO and employee pay. It looks likely that legislation on ethnicity pay gaps will soon follow.

The concept of fair pay has shifted significantly since the 2008 financial crisis. Before that, arguments about executive pay (and indeed about corporate governance generally) were about striking the balance between the interests of a company's shareholders and its executive management. During the 2010s, the idea took root that companies should be responsible to wider stakeholders and society as a whole. Executives are increasingly judged by the public in terms of their wider social impact. Executive pay has become a 'lightning rod' for negative feelings about a company's performance and behaviour.

Some trade unions are preparing to exploit these changing public attitudes. Unite, the UK's largest union active in the private sector, has adopted a strategy called 'strike plus'. It has hired a team of forensic accountants to search company accounts for information that can be used as 'leverage' in the PR battle over industrial disputes.

What Gillian Tett described as a *"notably different corporate zeitgeist"* was a long time in the making. But to paraphrase Ernest Hemingway, things changed gradually, then suddenly. The combined and cumulative effects of shifting social attitudes, environmental pressure, demographics, economic slowdown and political volatility were already lining up to bring radical change to the business world, when a global pandemic and a war in Europe combined to turbocharge the entire process.

As Tett says, these externalities are no longer mere footnotes. The forces outside the company's control are more powerful than they were, and companies ignore them at their peril. The social context of business does, indeed, matter. And Reward is in the front line.

> *We have identified five key areas in which it will be important for the majority of companies to develop a clear line, starting with purpose and values which then feeds through the rest of reward policy and practice.*

## 3.0
## WHAT TOPICS MIGHT A REWARD MANIFESTO NEED TO COVER

In such an environment, it is increasingly likely that companies will find themselves challenged on the values and principles that underpin their Reward policies. For this reason, it is important to consider in advance what are the range of topics in the wider reward space on which a company might reasonably be expected to have adopted a considered position.

Most senior Reward professionals will have a good understanding of the context in which their businesses operate. Scanning their business environments and anticipating where the reputational risks might come from will increasingly be an essential skill for the profession. The importance and likelihood of these risks will vary from business to business.

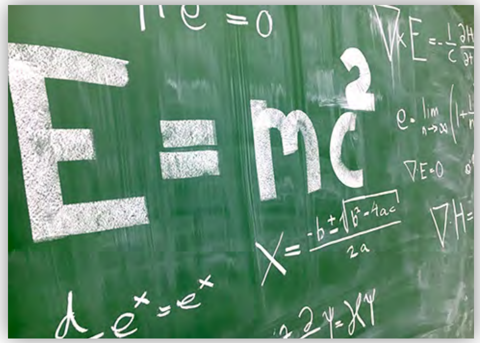
Nevertheless, in our conversations with Reward professionals and the other experts we consulted, we have identified five key areas in which it will be important for the majority of companies to develop a clear line, starting with the company's purpose and values which then feeds through to the rest of reward policy and practice.

### 3.1
### LINK TO PURPOSE AND VALUES

Companies need to be able to show that their reward strategies are aligned with their stated purpose and values. As we discussed in Section 2, this is becoming an important question, especially for younger employees and potential new hires. There is no more obvious way of challenging whether or not a company 'means it' than by challenging the extent to which the company's stated purpose conflicts with the criteria against which it pays people. Nowadays, if you say one thing but reward another, people will notice, and they now have more effective means to call you out.

For many companies, the link between the organisation's purpose and how and what it pays its senior people is far from clear. As Duncan Weldon observed:

> *"Most company annual reports contain statements about purpose but there is almost no way of linking this to how people's pay is determined. Even where companies communicate this well, the final piece – how does this actually translate to how you reward people – is rarely clear."*




### 3.2
### PAY QUANTUM

Whatever fine words a company puts in its annual report, it is the executive pay numbers that create the most focus and are most likely to be reported. It is therefore crucial that the company is prepared to explain how it decides what is fair in its reward decisions and the criteria it uses. If a pay decision is criticised as 'excessive' a company must be able to explain why it isn't.

It is particularly important that such decisions can be explained to key stakeholders in a way that they will understand how and why pay decisions were taken. As one HR Director remarked:

> *"There will always be some people who are outraged. What's really important is that I can explain the decisions to our employees, trade unions and investors. If they can get their heads around it, that's a good start."*

The reasons for selecting external market comparators, the balance between fixed and variable reward, and the selection of short and long-term performance measures should all be explainable in the context of the overall business strategy and objectives.

Duncan Weldon noted that people are asking more probing questions now about the basis of decisions on executive pay. References to 'external factors' won't cut it any more.

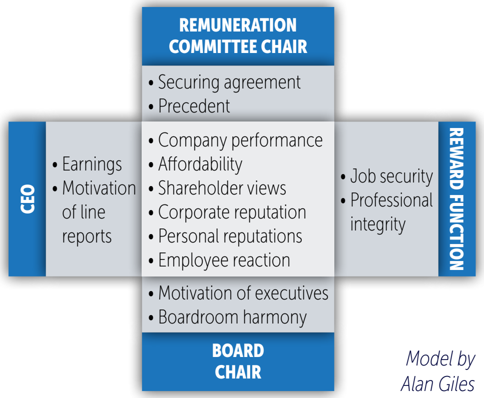
> *"Companies justify pay decisions by referring to factors seemingly outside their control. They will argue that it is linked to the share price or that 'we benchmark to our competitors'. This won't do any more. It is not a good enough answer to satisfy customers and potential employees who now hold companies to higher standards. It is clearly a circular argument and people can see through it. If you are part of the system that creates the benchmark, shrugging and blaming the benchmark doesn't really answer the question.*
>
> *"It would take us to a more interesting place if companies devoted more attention to show how their pay policy was linked to their overall purpose."*

None of this is to say that companies should go into granular detail about the calculations and algorithms used to determine performance and pay, beyond that already required in the Remuneration Report. It is, as one Head of Reward put it, about telling the story behind the numbers.

## 3.3
## CORPORATE GOVERNANCE AND REWARD MANAGEMENT

If people are to understand the context of reward decisions it is important to explain the process by which those decisions are made and how the company achieves an appropriate balance between the conflicting demands and interests.

In a well-functioning Remuneration Committee, there are a minimum of four key players who interact to achieve the consensus middle ground – as shown in the model below. Factors considered will include: Will reward drive organisational performance? Is it affordable? Will it be supported by shareholders? Is there a downside risk to our corporate reputation, or indeed our personal reputations? And how will our employees feel about it?




*Model by Alan Giles*

Publishing complex formulae might be of interest to technical experts but explaining how a RemCo weighs up the balance between 'formula driven' incentive payments and the exercise of business judgment requires considerable skill. Here, again, the company needs to be able to tell the story behind the process and the numbers. As one Head of Reward put it:

> *"We need to be able to articulate the decisions that the RemCo takes and that explanation needs to go beyond the formula."*

## 3.4
## USE OF ESG AND BROADER NON-FINANCIAL GOALS

As we discussed in Section 2, ESG is an area of keen focus from investors and, increasingly, from employees, customers and potential recruits. New graduates, in particular, are likely to ask about a company's ESG policies in some detail. They are only an internet search away from exposing any company that doesn't walk its talk. There are even websites geared to exposing 'greenwashing'. As Peter Boreham remarked:

> *"ESG, corporate purpose & stakeholder capitalism have created new questions around who the company exists to serve."*

None of this makes it any easier to explain the basis of Reward policy. As we discussed in our Trilogy on 'Performance Measurement earlier in 2022, ESG adds a number of new dimensions to what was already a complex subject. Furthermore, ESG is something of a catch-all term. There is often a conflict between the Environmental, Social and Governance aspects. All of which makes it more difficult to define organisational performance and, by extension, what a company is paying executives to achieve.

In some cases, companies may have been somewhat premature in including ESG criteria in their reward packages before fully understanding how to assess the impact of ESG activities on business performance. As one of the board directors we spoke to commented:

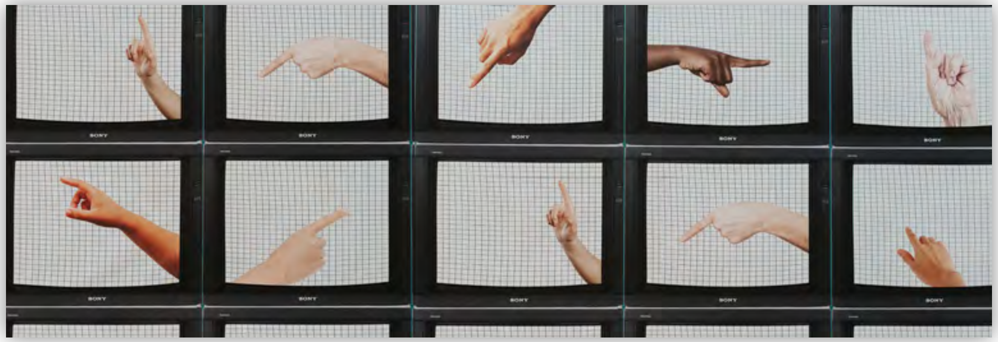
> *"In principle it is absolutely right that we include ESG activities in performance measures but this is in its infancy and most companies are still learning how to do it effectively."*

Alan Giles takes a similar view that:

> *"ESG integration into reward structures is arguably running ahead of accurate and unquestionable measurement."*

Nevertheless, the increasing focus on ESG means that companies must be able to explain the link between its stated purpose, its ESG goals, its business model and its 'must win battles'. The extent to which performance targets are based on corporate ESG goals and how these affect reward outcomes must be made clear.

Unless companies are clear about where ESG fits into their understanding of corporate performance and how that influences executive pay, they run the risk of not being taken seriously on any of their ESG commitments. Investors, customers, commentators and potential recruits know that if a company isn't rewarding its executives for advancing its ESG agenda, it will probably receive less focus. Difficult as this area is, saying nothing, or saying the bare minimum in the hope of avoiding trouble, could rebound and increase the reputational risk.



## 3.5
## DEVELOPMENT OF SOCIAL POLICY

We identified three key areas of social policy.

### 1. LATER LIFE EMPLOYMENT AND SUPPORT

An ageing workforce, a looming labour shortage and the demise of Defined Benefit pension schemes mean that later life employment policies are much more important now than they were even five years ago.

Realistically, a company's approach to later life employment is likely to be determined by the extent to which it considers that employees themselves should be responsible for both the 'investment risk' and the 'longevity risk' associated with their post-retirement income. (At least, it is hard for a company to argue otherwise). In recent decades, increased labour mobility and the demise of the single employer career have led many companies to assume that the retirement arrangements of their current employees were no longer the company's problem. However, most companies now are realising that they need to take a more active stance on this issue than they did in the past two decades. (PARC covered this topic in significant detail in our ***Retirement Strategy Report*** in March 2022).

For sound commercial reasons, more companies are now developing strategies for later life employment, managing the transition to retirement more flexibly, and providing financial education. With the increasing importance of attracting and retaining older workers over the coming decade, clearly articulated policies in this area will assume greater relevance.

### 2. APPROACH TO THE PROVISION OF BENEFITS GENERALLY

As with reward generally, a company's position on benefits can send signals about what it values. Does the company see itself as a facilitator, giving employees access to benefits at a lower cost than they could buy for themselves because of the purchasing scale of the employer? To what extent does it provide flexibility in the choice of benefits that reflects the diversity of its employee base.

### 3. GENDER AND ETHNICITY PAY DIFFERENTIALS

Gender pay gap reporting is now a statutory requirement for UK companies and it looks likely that similar requirements will be put in place for ethnicity pay gap reporting in the near future. It is also an area of increasing media and public focus. Even without the legislation, it is likely that gender and ethnicity pay gaps would still have become an area of reputational risk. The trouble is that the statutory reporting requirements are statistical blunt instruments, which don't leave much room for nuance. It is therefore crucial that companies understand the reasons for any pay gaps and the extent to which they need to be addressed. As one Reward consultant said:

> *"The companies that do this well are the ones that were already looking at this in detail before they were forced to, and which therefore have data and reporting at a more granular level. That helps them when they come to explain gender and ethnicity pay to a somewhat sceptical public."*

A deeper statistical analysis sends a signal that the company takes the issue of gender and ethnicity pay gaps seriously.


## 3.6
## OTHER TOPICS TO CONSIDER

This section could never be an exhaustive list of topics for a Reward Manifesto. The most salient issues may well vary from one company to another, and from one sector to another. For example, in some sectors, employee Health and Safety is a significant reputational and operational risk factor. Demonstrating how safety criteria impact on executive reward is crucial to the management of this risk. Equally, an increasing number of organisations now see Employee Wellbeing as a key element of corporate reputation.

As some of the Reward practitioners we spoke to can attest, a reputationally damaging reward story can sometimes come from a completely unexpected quarter. One of the key skills for senior Reward professionals in the coming decade will be the ability to scan the horizon and anticipate where such risks might arise. Here, the concept of materiality is useful in determining whether the topic is material to a company's business model and strategy. A similar test might be used to determine the subjects on which a company should not have a clear policy. There is little point in 'ticking boxes' that have minimal relevance to the business.

Conversely, there will also be topics where companies consider it unwise to make policy statements, for the reason that they might be deeply divisive; for example, an issue such as abortion rights in the US.

Crucially, the areas on which a company has a clear position, and the policies themselves, must be seen to support its overall purpose and values. In a Reward Manifesto, then, there should be a clear and discernible thread running throughout the document. Inconsistency of approach between different aspects of the Reward Manifesto would be counter-productive and could end up presenting the sort of reputational risk it was designed to avoid.



## 4.0
## WHAT SPECIFIC QUESTIONS MIGHT YOU NEED TO ADDRESS

The purpose of the Reward Manifesto, is to gain a clear and shared understanding of the topics outlined in Chapter 3, in order that the company will be better placed to explain the company's policies and decisions on questions related to Reward.

Inevitably, there will be overlaps and interdependencies between the subject areas we have highlighted, and it is as important to ensure consistency between them as it is to gain clarity around each one. So, for example, are you clear about how your company does define performance? Can you explain how your definition of performance relates to (and derives from) the company's purpose? Do you have clearly linked measures of performance? Are these measures understood and supported by your stakeholders? And can you explain all this succinctly to employees, investors, and media?

The story is as important as the numbers. What then are typical questions that senior management needs to address in each of the above topic areas in order to develop a clear and sustainable position that covers the necessary 'angles'.

### 4.1
### PURPOSE AND VALUES

**Are you clear about how your reward strategy is aligned with your company's stated purpose and values. Is this link clear to all stakeholders?**

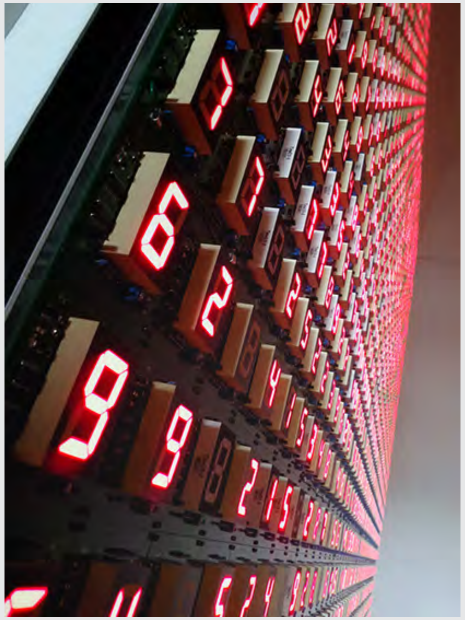
- Is your organisation's purpose clearly articulated?
  - Is this purpose perceptibly in line with the prevailing values in the organisation?
  - Does your stated purpose clearly relate to your organisation's business model – *(how it plans to generate a sustainable profit stream)*
  - Does your purpose reflect how the organisation behaves in practice?
  - Does your stated purpose encourage people to join and stay with your organisation?
- Do your reward policies and principles reflect your organisation's purpose and values?
  - Are your reward principles communicated sufficiently deeply within your organisation – to employees and to wider stakeholders?
  - Are you clear about which aspects of your reward policy you are prepared to communicate openly and publicly?
  - Are you clear about which aspects need to remain confidential and can you explain why?

### 4.2
### PAY QUANTUM

**Are you clear about what you consider to be fair reward in the context of organisational performance? Are you clear on those elements that may be considered excessive in pay decisions?**

- Are you clear where and how you draw the line on quantum of reward?
  - Do you have a clear policy on the 'pay ratio'?
    - » Can you explain the differentials between the CEO and employees at the 25th, 50th and 75th percentile?
  - Can you explain what is an appropriate differential in reward between a high and a median performer?
  - Can you explain what you consider to be an appropriate incremental level of reward opportunity for real 'out-performance'
  - Does the organisation have a clear policy on whether to 'cap' the level of pay-out under incentive plans?
- Can you explain which markets you use as external comparators and their relevance to the business?
  - Are you clear about the relative importance of internal vs external comparability?
- Are you clear about what level and structure of reward is dictated by performance against pre-defined measures and targets?
  - Can you defend the relevance, accuracy and integrity of the measures used?
  - Can you explain your mix of 'fixed' vs 'performance-based' reward – for key segments of management?
  - Can you explain the balance between short-term vs long-term focus in overall reward?

  - Are you clear about the circumstances in which 'discretion' (business judgment) may be applied – and the approval/s required?
- Do you have a clear policy on deferral and clawback?
  - Are you clear on when it is appropriate to defer the pay-out of an incentive – until there is greater clarity around the impact of real or underlying performance?
  - Are you sure you have the contractual right to deliver clawback?
- Are you clear on the relevance of reward comparisons with the general workforce?
  - Do you believe in the concept of 'sharing the pie' – how broadly, and with whom?



## 4.3
## CORPORATE GOVERNANCE IN REWARD MANAGEMENT

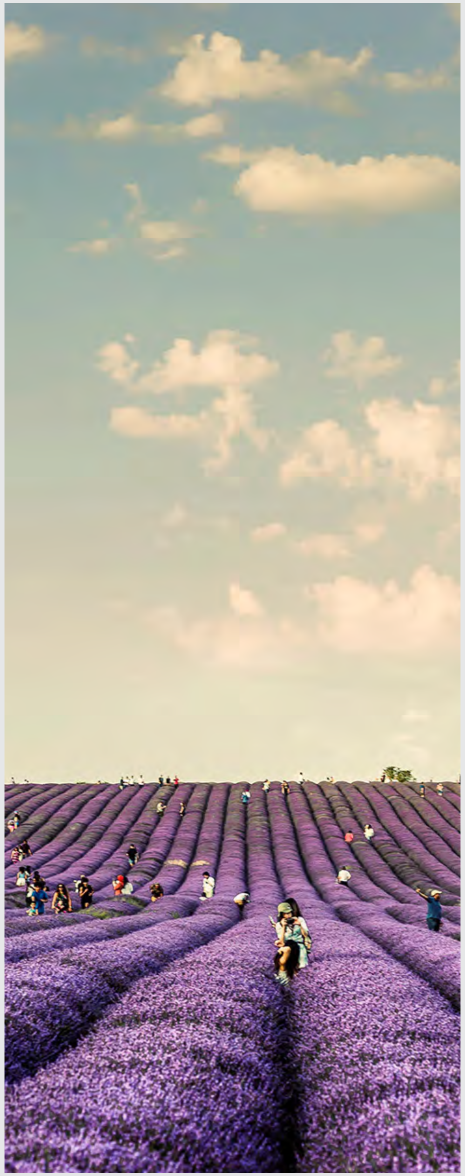
**Is your reward decision making process perceived as both fair and responsible?**

- Do you have a clear process by which the Remuneration Committee makes decisions on critical reward issues
  - Does this process balance the interests of different stakeholders?
  - Are the respective roles of the RemCo Chair, Company Chair, and the CEO clearly defined?
  - Are the roles of the other NED members of the RemCo and the Senior Independent Director clear?
  - Is there clarity around the role, parameters, and accountability of external consultants?
- Are you clear about how far RemCo decisions may deviate from pre-defined 'formula driven' incentive payments?
  - Is it clear what level of 'discretion' (business judgment) may be exercised in determining the level of pay-out and under what circumstances?
  - Is the extent to which the RemCo should focus on underlying performance – and the delivery of shareholder value, made clear?
  - Do you balance the accuracy of the performance measurement process vs the complexity of the administrative burden?
- Does the RemCo have clear measures to evaluate its own processes and the effectiveness of its execution of reward practice?
  - Does it apply that learning to future practice?

## 4.4
## USE OF ESG AND BROADER NON-FINANCIAL GOALS

**Are your ESG goals linked visibly to your business model and 'must win' battles?**

- Is the process clear and intuitive by which your ESG goals are defined?
  - Are your company's ESG goals visibly linked to your business model?
  - Are the measures relevant, objective and defensible?
  - Are your ESG goals communicated widely – both within and outside the organisation?
- To what extent are executives incentivised to achieve the company ESG goals through their reward plans?
  - Is it clear which behaviours or outcomes might lead to the cancellation of an incentive pay-out?
- Is it clear how the company will manage any conflict between financial and non-financial goals?
- Is it clear how the company will manage any conflict between the respective 'environmental', 'social', and 'governance' aspects of ESG goals?



## 4.5
## DEVELOPMENT OF SOCIAL POLICY

### Policy on later life employment and support

- Does the company have a clear approach to supporting employees into 'later life' employment?
- Does the organisation have a managed 'glide' path into retirement, including, for example, reduced working hours?
- Does the company provide financial education – in helping employees to understand the range of investment products, providers, services, and costs?
- Does the company explain the concepts of 'investment risk' and 'longevity risk' associated with their post-retirement income? Are the risks of managing this made clear to employees?

### Approach to the provision of benefits generally

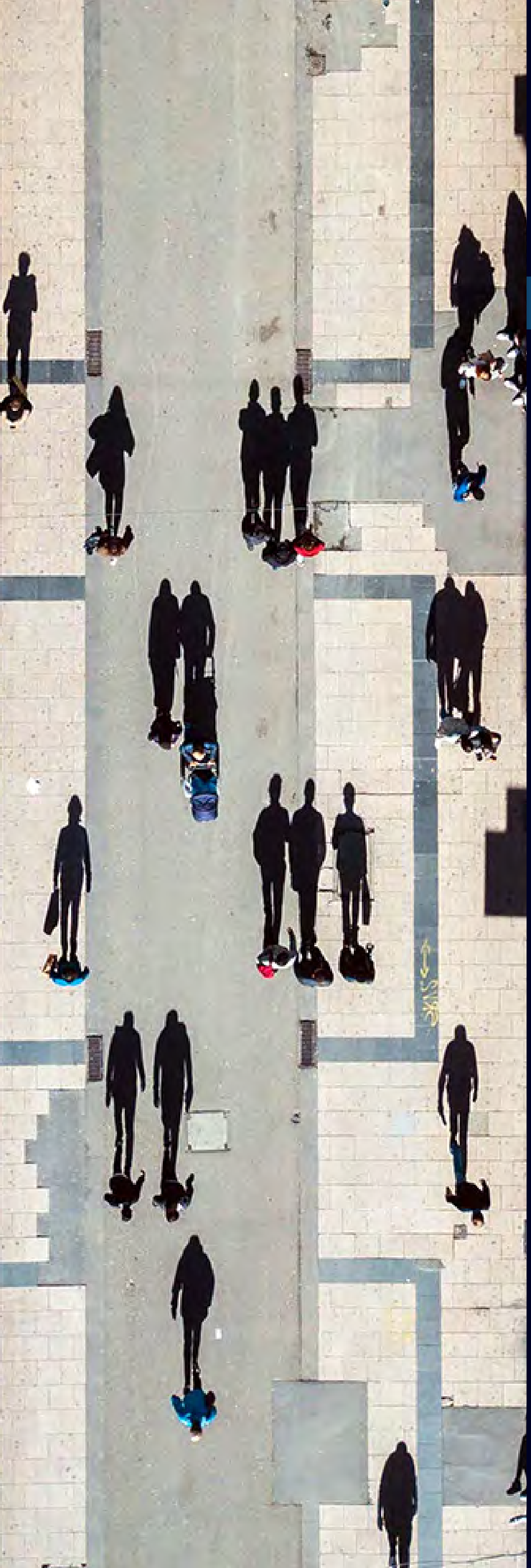
- Does the company have a clear approach to the provision of benefits?
- Does the company see its role as that of a facilitator – giving employees access to benefits at a lower cost than they could buy for themselves because of the purchasing scale of the employer?
- Does the company have a minimum 'floor' of benefits for every employee?
- Does the organisation allow flexibility and choice to reflect individual circumstances?

### Gender and ethnicity pay differentials

- Is the distinction between 'equal pay' and 'gender pay' widely understood – and addressed via different approaches, as considered appropriate?
- Have you analysed the gender and ethnicity pay gaps at different level and for specific key roles within your organisation?
- Do you have a clear methodology for identifying and quantifying any such gaps?
- Does the level of granularity of the analysis enable you to understand the underlying causes of any gender and ethnicity pay gaps?
- Do you understand how any pay differences may have arisen?
- Do you have current plans to mitigate any such gaps?

This list of questions is intended as 'indicative' only. The level of detail needed in addressing the various topic areas may well vary between individual companies and sectors. Furthermore, HR and Reward professionals will have a clearer and more informed view of the sort of questions that resonate within their own organisation.

While it is essential to have the data to back up these statements it is also necessary to tell the story around them. In an age in which stories travel rapidly by social media, it is as important to be compelling as it is to be convincing – and the underlying rationale needs to be crisp and succinct.





# 5.0 CONCLUSIONS

As we launch this report, the global energy shortage and its impact on the cost-of-living crisis are dominating the news agenda. As we have seen, it is very likely that this will focus still more attention on the behaviour of large companies and on the structure and level of reward packages for their senior executives. While much of this reaction will inevitably focus on companies involved in the energy industry, other large businesses will not escape the pressure. Trade unions have already said that they intend to use executive reward as 'leverage' in the PR battle over pay disputes and industrial action. It is almost inevitable that some of the public anger over the economic situation, together with the increased scrutiny of companies, will lead to a focus on reward policy in all organisations. If, for whatever reason, a company makes the headlines in the morning, by the evening, the pay for their senior executives may well be in the spotlight.

As Duncan Weldon remarked during our discussions:

> *"The economic outlook is dire so the pressure is only going to get more intense. It therefore makes sense to put yourself on the right side of this now."*

We have seen some disastrous effects when senior executives make off-the-cuff remarks in the face of hostile or probing questions from employees, investors, or media. Such responses can be at best, embarrassing or at worst, career ending. When adverse stories break, companies must be prepared with a considered and appropriate narrative – often on topics wider than the initial story. In such circumstances, it will no longer be good enough for senior individuals just to 'wing it'. It is essential, therefore, that a company's Reward Manifesto reveals a collective ownership of its key values and principles.

In this Report, we have identified a set of topics, where – in the opinion of PARC and of the reward leaders and stakeholders we consulted – companies are best advised to clear their lines and have a defensible and sustainable line of argument. Even if the reasoning is clearly set out in the annual report or elsewhere, the format may not be easily accessible nor expressed in the clearest and focused language to win the argument.

The Reward Manifesto is a discipline for expressing a shared understanding of the organisation's reward policies and decisions. In Sections 3 and 4, this Report provides a framework and a starting point for the necessary discussions.

- The level of reputational risk in each area is likely to vary between sectors and organisations. Working through the questions in Section 4 will help the HRD or Head of Reward to assess the potential level of risk, and to determine those areas where the organisation needs to have developed a clear response.
- We argue that the position the company establishes in each of these areas should then critically be endorsed by the Board and its Committees.
- We re-emphasise that the aim of this report is not to be prescriptive in the sense of telling organisations which policies they should have or what their policies should be.
- We contest, however, that having a clearly defined policy that is understood at all levels of the organisation will be essential if and when a negative reward story in one of these topic areas appears in the press or on social media.

Preparing a manifesto is therefore a process to check alignment, triangulate the perspectives of all legitimate interested parties and calibrate consequences for a range of potential performance outcomes. It therefore provides a framework to assess specific decisions and forms the basis of the remuneration committee's shop window for a public company, the directors' remuneration report. It also provides the manual for PR if a negative story with a pay impact develops.

In her FT piece quoted in Section 2, Gillian Tett emphasised that the corporate zeitgeist had changed significantly, even before the Covid outbreak. The events of 2020-22: pandemic, social protest, climate incidents and invasion, have only served to heighten the extent to which companies must now take account of the broader social context in the way they represent themselves publicly. The looming cost of living crisis and the economic headwinds of the 2020s will only increase the level of scrutiny on companies.

Developing a Reward Manifesto will be an invaluable tool for managing and mitigating the inevitable reputational risk faced by many, if not most organisations. Our recommendation is to review the checklist of topics highlighted in Section 3 and to use this paper as a framework and a guide. We know the economic pressure is likely to become more intense as we go into 2023 and beyond – and that companies will be in the spotlight. This approach will be a critical tool in mitigating the risks to your organisation's reputation.

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For more information about PARC and how to become a member of our network, please contact: Karen Clark, karen@parcentre.com

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