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Driving force

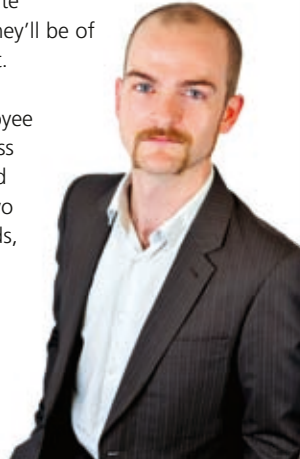
The old saying goes that you can take a horse to water, but you can't make it drink. Likewise, you can make sure your employees arrive at 9am, but you can't – short of standing over them and shouting – make them work.

Or, perhaps more accurately, you can't force them to *engage* with their work – to care about the business as a whole and their contribution to that. And you can't just buy their engagement either. You can offer massive bonuses, but that's not sustainable. You can offer private healthcare, a solid pension or free lunch vouchers, but you can't guarantee they'll be of the slightest interest to your workforce unless you've engaged with them first.

If there's one lesson to be drawn from the articles that follow, it is that employee engagement isn't something that can be imposed from the top-down. It's a process by which the company is made more attractive to its staff, and *vice-versa*, and that can only occur when there is effective communication between those two groups. That kind of dialogue is not easy to start, or maintain, but the rewards, shared by the whole business, are worth it.

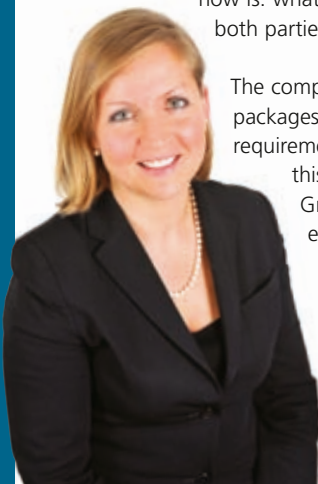
Gareth Pearce

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There are a range of political, economic and social issues that have combined to radically change benefits in the workplace. This issue of *ICSA Focus* aims to examine these changes and how they affect the way we engage, motivate, recruit and retain staff – all major issues many company secretaries are grappling with currently.

Approved all-employee share plans have seen a year-on-year increase recently and, with the majority of FTSE 100 and a large number of the FTSE 250 companies offering approved schemes, the question now is: what else can be done to encourage employees and employers to act so that both parties gain the maximum benefit from the provision of these plans?



The company secretary's role in developing and promoting employee remuneration packages, as well as ensuring that these meet the needs of stakeholder requirements, is a current and pressing issue. To show how others have dealt with this situation we have included practical case studies from Admiral, National Grid and Petrofac, showing how they have developed schemes for long-term engagement of staff at all levels.

I hope you will find the articles thought-provoking and useful in planning your way to a tailored and responsive employee engagement system.

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ICSA FOCUS

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Strong hold



With increasing numbers of people choosing portfolio careers, how can companies effectively retain skilled staff?

Our expectations of work are changing. The life-long career with one employer has been replaced by a more mobile model, with individuals taking on several shorter periods of employment for a succession of employers. It should be noted there has been a considerable difference between male and female employment patterns; conventionally many women had long breaks to care for children, but recent legislation has begun to balance the inequalities and allow both sexes greater flexibility.

It is anticipated that the next generation of employees will have truly 'portfolio' careers, spending shorter terms with individual employers and developing translatable skill sets allowing them to take roles across different industries. Add that to the fact that we are all now expected to work longer, thanks to the abolition of the default retirement age, and you can see the issues employers face in retaining skilled employees.

These changes are likely to challenge the conventional wisdom about how to attract,

recruit and retain those with the right skills and attitudes to benefit an employer. These skills and attitudes are captured in the concept of the 'engaged employee' – a committed, focused, hard-working person who will on occasion go above and beyond the duties or roles set out in their job specification to help the employer build or grow their business. This is not a set of behaviours that can be defined in a contract of employment. It is a two-way relationship that involves a committed, caring, flexible and engaged employer; a more adult relationship than the old paternalistic master/servant model.

There are many aspects of the work experience that motivate people and turn them into engaged employees. Most of these are unlikely to be financial; they will be concerned with the satisfaction a job provides, the status, control, achievement or recognition gained. Financial rewards are obviously an important part of a compensation package, but it is the overall experience of working for an employer that creates engaged employees. Benefits are a key tool in an employer's compensation armoury; they can be used to

encourage and reward desirable behaviour patterns and demonstrate an employer's commitment to the relationship.

Benefit

When asked, most employees express a degree of trust in their employers. They expect them to have vetted any financial arrangements, and to have carried out due diligence on any employee benefit. They also expect employer sponsored schemes to offer value for money when compared to the arrangements they could make as individuals. Expectations of the benefits that an employer should offer vary widely between different sectors. Some benefits are 'hygiene factors', not highly appreciated on their own, but considered essential if they are missing. Other benefits do provide motivation – share schemes, long-term incentive schemes, company cars or cash bonuses are all desirable enough to drive behaviour

An employer's benefit structure should be appropriate for the sector, but those companies who take the time to be better than the average can use benefits as a powerful differentiator, attracting the best available staff. In any business, it is the employees who create and develop the company culture and drive its success. We have seen this very clearly in the investment banking sector, where major companies remain convinced that they cannot afford to lose their talent, and continue to pay very substantial benefits to retain staff despite vociferous criticism. A similar trend exists in the FA Premier League, where the finishing position of a club appears directly proportional to the size of their wage bill. It seems that the most expensive players really do score more goals. Exceptions to this rule occur in football when charismatic managers gain a personal commitment from their players, upsetting the odds to beat bigger rivals in a clear example of highly engaged management and staff at work.

In these sectors, the reward strategy has a direct impact on the commercial success of the business and provides evidence that employers should do as much as possible to achieve employee engagement.

Relevance

If an employer wants to offer cost effective benefits that are truly valued, the traditional paternalistic approach should be avoided and the demands of the workforce should be heeded.

To gain and hold someone's interest, a company needs to offer them something relevant, something which has meaningful value from their perspective. Benefits should address needs that are recognised by the recipients, rather than fitting into

a grand structure of what is thought to be relevant. Poorly targeted benefits are often unrecognised, unappreciated and ultimately unsuccessful in meeting an employer's objectives. People have different needs, priorities and objectives at different stages of their working lives. This requires benefits to be targeted at specific segments of the employee population, with different shapes and levels of benefit.

Young graduates with significant debt will be more interested in incentives that help reduce this burden and help them build up a nest-egg for a property purchase or other life ambition. Structures that offer more immediate gratification, such as a cash bonus, are perceived as more attractive than a pension scheme contribution that will pay out in 40 years. By contrast, someone in their 40s with a family is likely to value the protection element of their benefit package and have a much greater appreciation of the pension contributions, as retirement will appear much closer. Someone nearing retirement may value the medical and pension benefits more highly than the income protection benefits or life assurance benefits.

Targeting benefits requires an understanding of what is needed by, and is important to, a particular segment of the workforce – after all, senior managers have very different reward expectations to the industrial workforce.

Value

Employee benefit budgets are significant, ranging from 5 per cent to 15 per cent of basic pay, depending on the generosity of the employer, the sector they operate in and the number of benefits they provide.

There are many different types of benefit available – some focus on protection against unexpected events, such as death, disability, or illness. Others offer immediate monetary rewards, such as bonus or commission payments; while some have a longer-term

Steps to engagement

A checklist for using benefits to improve employee engagement:

1. Agree the business objectives for your organisation and the part that benefits must deliver.
2. Agree the budget – typically a rough percentage of payroll.
3. Survey your key employees to discover what makes and keeps them engaged.
4. Design your benefits with clear deliverables.
5. Consider introducing a benefit platform to facilitate flexibility and avoid regimented benefits that stagnate.
6. Communicate with your employees, get them involved in the design process, have champions for certain benefits or behaviours.
7. Assess the impact of any changes, measure what has been achieved, get employees involved in this process.
8. Change your design, provider, and structure to reflect the feedback you have received. Keep your benefits relevant and up-to-date.

in the deficiencies on their own. Although this model is efficient for an employer, it does not engage staff members – few people fit the 'normal person' mould used as a proxy for design purposes. Attempts to improve this model by introducing flexible benefits saw a significant increase in the complexity and cost of the arrangements for employers. Less onerous, but more effective methods of allowing staff choice over benefits appears to be developing as IT systems improve. Certainly, larger benefit providers are seeking competitive advantage in the run up to the introduction of the auto-enrolment duties for workplace pension schemes from October 2012.

These developments could be described as 'flex-lite', although the range of services offered may end up being considerable. At this stage, a watching brief on how this area develops should be kept by the company secretary.

Ask your staff

The first stage in ensuring that benefits are appropriate is identifying the members' needs. We suggest that employers conduct their own

only three or four times. Needless to say, this benefit has been amended for new joiners.

A carefully constructed survey can identify the benefits that add value; perhaps the ones that employees find too difficult or too expensive to arrange as individuals, such as healthcare. Sometimes it is where the employer makes a substantial financial contribution, such as with pensions. Occasionally the valued benefits are less about direct cost and more about flexibility, perhaps the ability to buy additional holiday, or to work flexible hours.



Whatever the final structure may be, it will not increase staff engagement unless they are aware of how it will benefit them. Clear communication of the facts and benefits is vital. A well-targeted benefit that no-one knows about will not be recognised, wastes effort and money and takes us back to square one.

Effective communication is a large topic, which we cannot hope to cover in this article, but any message should be clear, concise, targeted and repeated if the information is to be received and understood.

Involving employees in the communication process will help employers identify the most effective methods of spreading knowledge and will, literally, engage some staff with the benefits on offer, allowing them to understand and champion the cause. If the benefits are relevant and meaningful this information can spread virally through company intranets, e-mails and team meetings. ■

The demands of the workforce should be needed.

incentive role, such as shares and long-term bonus schemes. For the very long term, saving into tax-advantaged pensions plays a key role in enabling an exit route from employment at the end of a working life.

Picking the right combination of benefits and adjusting these when necessary is difficult and expensive. Traditionally, employers have avoided the cost and complexity by imposing a core package for all and leaving staff to fill

research within their organisation to ascertain the relevance of particular benefits and to discover the reward elements that really get staff engaged.

During a recent research exercise for a large client with over 5,000 full-time staff we found little understanding of their life assurance benefit, even though this was an astonishing 12 times basic salary for historical reasons. When questioned, members thought it was

» About the author

Neil Latham is Principal at Punter Southall DC Consulting. The views of the author are not the views of Punter Southall Limited as a whole.

Shared resources

Employee share plans remain one of the most popular ways for companies to attract, retain and motivate their employees, says **Christina Hamilton**.

While companies continue to seek cost savings across the board employee share plans remain popular, despite the absence of any review of holding periods and contribution limits by either the previous or current Government. Nine out of ten listed companies in the UK offer an employee share plan, and three million employees currently participate in a plan.

At Capita we have noticed a trend in client companies – many are showing an increased interest in both extending existing schemes, and also setting up new plans to compliment those already in place.

Our experience is that the interest in share plans remains buoyant due to a number of factors. First, with regard to Share Investment Plans (SIP), employees continue to be confident that the economy will recover meaning stock values will be higher in three to five years' time. Second, interest rates on traditional savings products remain unattractive and, while these rates also apply to bonus rates on Save As You Earn (SAYE), the confidence in a rise in stock values has kept participation levels healthy. Finally, as the trend in lower mortgage interest rates continues, disposable income for those on a variable rate has increased. That, coupled with an understandable desire to save due to current uncertainty, means that share plans are seen as a prudent savings vehicle.

In order for a share plan to work and achieve the intended results, in terms of employee participation numbers, it's important to present the plan in an effective way – that is, to ensure that it is fully understood by employees. This is particularly important for clients introducing a plan for the first time. To further illustrate the importance of employee engagement and clarity of communications, here we present several client case studies to show different approaches, each tailored to their unique employee base.



» About the author

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Don't be afraid to be flexible

As your business grows, it pays to be flexible – and share plans are no exception, as Petrofac recently discovered.

As a global provider of integrated facilities solutions to the international oil and gas industries, Petrofac is a business that is reliant on attracting and retaining good people – as in any people business, they are the key factor that delivers the group's performance.

Appreciating that the best guarantee of the group's long-term success lies in aligning the interests of shareholders and employees, Petrofac introduced two discretionary share plans at the time of its initial public offering in 2005, plus a share incentive plan for UK employees and a further discretionary share plan in 2006. This strategy has certainly proved its worth – since flotation the group has expanded rapidly and is now an established member of the FTSE 100 with some 14,000 employees operating out of five operational centres, in Aberdeen, Sharjah, Woking, Chennai and Mumbai, and a further 19 offices worldwide.

Changing the rules

Petrofac's commitment to employee share ownership, and the importance this plays in assisting with its strategic delivery, was recently demonstrated when a number of Petrofac group employees transferred to Petrofac Emirates, an Abu Dhabi-based company. Because the group only owned 49 per cent of the share capital of Petrofac Emirates, such employees were not eligible to participate in the group's Deferred Bonus Plan (DBSP) under the plan's existing rules. However, the company was still very keen to incentivise employees of Petrofac Emirates through the DBSP, particularly as many of the staff had previously participated in the scheme as Petrofac employees.

To resolve the issue the company used its AGM in May this year to pass a resolution. This amended the rules of the DBSP to extend participation to Petrofac Emirates employees. Additionally, to retain flexibility in the event that the company enters into further joint-ventures in the future, the resolution allowed the Remuneration Committee to determine that the employees of any company in which the company directly or indirectly holds 25-50 per cent of the issued share capital may participate in the DBSP. This ensures that staff in Petrofac Emirates – and future joint ventures – can continue to receive the same benefits from the DBSP as their colleagues in the Petrofac group.

Andrew Wilkison is Share Plan Manager at Petrofac.

Turning staff into shareholders

Stuart Clarke of the Admiral Group explains how the company successfully uses free share schemes to reward and motivate their people.



Chairman Alastair Lyons, noted: 'In accordance with our philosophy of giving all our staff a stake in what they create by making them shareholders, this excellent performance will mean employees will again realise the maximum award of £3,000 free shares in recognition of the achievement in full of the 2010 objectives within the Approved Free Share Scheme. Someone who has been employed since flotation now has the potential to hold 2,041 shares under this scheme, worth £34,000.'

DFSS, the Group's other plan, is unlike many plans of this type because the awards are spread throughout the organisation from senior managers to 'star performers' – employees who have excelled in their role during the year and who would not normally receive DFSS shares. Overseas employees are also eligible to receive awards within the DFSS.

Admiral is a very unusual place to work. There is a genuine philosophy that if employees are happy, their work will be of a high standard. And the senior management at Admiral really do care how the employees feel about working here.

Of course, there are many companies out there that will tell you exactly the same thing – but in our case, the proof is there for all to see. In the 11 years that the *Sunday Times* has been running its annual *100 Best Companies To Work For* survey, Admiral has featured in the list every year. This year we have achieved our highest-ever position by being ranked ninth, an excellent result for the company and everyone who works for us. This was achieved thanks to a whole package of measures designed to keep our staff happy and motivated. A big part of that package comes in the form of our two schemes for distributing free shares to our staff – known as the Approved Free Share Plan and the Discretionary Free Share Plan (DFSS).

At Admiral, share ownership is a very important feature of the remuneration of employees – our board firmly believes that share ownership motivates employees, decreases attrition and improves the Group's recruitment prospects in the regions where its offices are located. And that view is clearly shared by our staff, with 78 per cent of employees saying that they are more likely to stay with Admiral because of the share schemes.

How it works

All UK employees are eligible to receive shares in the Approved Free Share Plan. In 2010, Admiral made a full award of £3,000 worth of shares to over 3,500 employees. In fact, the Group has issued £3,000 worth of shares to each eligible member of staff since it floated in 2004. In the 2010 report and accounts,

Our Remuneration Committee believes that as the DFSS develops, and awards continue to vest, it will have the effect of reducing staff attrition and further strengthening the alignment of the interests of staff and shareholders. In April 2011, over 1.5 million shares were awarded, shared among just under 1,500 members of staff. In May 2011, the 2008 scheme vested in full with over 1,700 members of staff sharing £19 million in proceeds.

Performance-related plan

The criterion we use to determine how many shares vest under the DFSS is the growth in earnings per share in excess of a risk-free return – defined as average three-month LIBOR (London Interbank Offered Rate) – over a three-year period. The Committee feels that this is a good indicator of long-term shareholder return.

For the vast majority of staff, awards will be split, with half of the award subject to the above performance criteria, while the other half only requires that the recipient is an employee of the Group at the date of vesting. The change was made to help us attract high-calibre staff by providing more certainty over the outcome of vesting awards. In addition, the Group pays a bonus to all holders of DFSS shares. The bonus equates to the dividend payable on an equivalent number of the ordinary shares of the Group. We feel that having a group-wide bonus equivalent to the dividend flow received by investors further aligns the incentive structure with shareholders.

Stuart Clarke is Head of Share Schemes at Admiral Group plc.



Clear communication

The high level of employee participation in National Grid's Sharesave scheme is thanks both to the scheme's design and an active approach to employee engagement.



National Grid has a long history of encouraging employee share ownership – it launched its first Sharesave (SAYE plan) in 1986, and further expanded its employee share plans offering at a later date to include a Share Incentive Plan (SIP) and equivalent overseas plans. Participation in the Sharesave is well above the average, at 74 per cent, and just over half of all employees are already shareholders in the company. So how does the company achieve this impressive level of employee engagement? Fundamentally, it is a result of National Grid's firm view that employee share ownership is an integral part of its success, and this drives the way that it presents Sharesave to its employees.

Planning the plan

First, the company made some conscious decisions around the plan design. It was important to make Sharesave available to as many employees as possible, so the plan is open to all UK employees who have one month's service as of the invitation date. The company also takes advantage of the full features of Sharesave, in that employees can elect either a three and/or five-year term in each invitation, and options are discounted by the maximum 20 per cent. This plan design maximises the benefits of Sharesave to employees and, coupled with the low eligibility criteria of one month's service, it shows the company's commitment to make the plan as attractive as possible.

The considerations around the design of the plans is

carried through to maturation. The company deliberately does not offer a straight-through dealing service. National Grid wants Sharesave participants to become shareholders. Employees are, however, able to sell these shares on receipt of their share certificate if and when they decide to do so. Many participants choose to retain their shares post maturity, and there are currently some 5,300 UK employees beneficially own shares.

Second, National

Grid puts a great deal of effort into communicating its plans and canvassing opinions from focus groups to improve this year-on-year. A group of Share Scheme Co-ordinators across the business meet twice a year to give fair and honest feedback gleaned from colleagues. They review invitation and maturity documents, application methods and helpline performance. Suggestions from this group that have been implemented to date include: more reminders internally around closure or expiry dates so deadlines are not missed by employees, and the themed development of the brochure artwork. They also continue to look at developing other technological solutions, such as SMS applications for invitations and maturities. National Grid uses many methods of communication, including printed material, e-mail, web, telephone and intranet. A significant number of employees are field-based, and therefore without intranet access – for those employees a telephone dial-in facility is provided to enable them to pick up key messages and updates. Finally, because Sharesave maturities are in the majority profitable, this encourages employees to re-invest in future schemes and provides good word-of-mouth among employees which helps promote the plan to others within the company. This is the most effective way to remind employees that Sharesave is much more than just a savings plan.

Robin Kerner is Assistant Secretary – Share Schemes at National Grid.

Hidden costs

Mike Landon looks at the implications of the new 'disguised remuneration' tax charges on share plans.



When draft legislation to counter tax avoidance through 'disguised remuneration' was revealed last December, it caused widespread concern amongst companies.

The proposed provisions would have resulted in unwelcome tax charges for employees participating in many absolutely standard employee share plans. Fortunately, the Government has listened to the advice it has been given since then. Most – though by no means all – share plans will now be exempt from the new tax charges.

The 'disguised remuneration' legislation was mainly targeted at family benefit trusts, which have increasingly been used to provide benefits to employees – for example, through loans or use of property or other assets – without a tax charge arising on the full value of the money or asset. It provides that there will be an income tax charge and national insurance contributions (NICs) on the value of the sum of money or asset which is transferred or otherwise made available to an employee by a third party, such as an employee benefit trust (EBT).

The provision that caused particular alarm, however, was that a tax charge would also

arise when money or assets were 'earmarked' for employees, with a view to them being transferred or made available in the future. Many share plans include arrangements for the shares to be delivered to employees through an EBT.

In the original version of the draft legislation, income tax and NICs charges were likely to be triggered at the time when the trustees of an EBT decided to allocate shares to specific employees in anticipation of the shares being delivered to the employees when they were exercised or vested. Employees would have been taxed on the full value of the shares at the time of this 'earmarking', even though they might not become entitled to the shares until many years later.

Developments

MM&K and other leading share plan advisors have had numerous meetings with HM Revenue & Customs (HMRC) to explain the problems which the proposed provisions would cause and to suggest ways of protecting share plans that have no tax avoidance motive. The Government has taken our recommendations into account in the Finance Bill, published at the end of March. However, this contained 60 pages

of extremely complex exemptions which would have still left many standard share plans subject to the 'disguised remuneration' charge. Further amendments to the Finance Bill have dealt with most of these problems. Companies will need to obtain professional advice to ensure that their share plans fall within the new exemptions. The following arrangements are now unlikely to result in tax charges under the new rules:

- Any plan which involves new shares or treasury shares being issued by the employing company (or another group company) directly to the employee.
- Any of the HMRC 'approved' share plans – Share Incentive Plans, SAYE Option Schemes and Company Share Option Plans – and Enterprise Management Incentives.
- Standard 'unapproved' conditional share award or deferred share award plans, provided that the awards vest on a specified date and that the employees become entitled to the shares (and liable to tax) on the vesting date.
- Awards of restricted securities, including basic Joint Share Ownership Plans (JSOPs).
- Standard 'unapproved' share options, again if they become exercisable on a specific date and expire if not exercised within ten years of their date of grant.
- Share awards and share options, which vest on the occurrence of an 'exit event', such as flotation on a stock exchange or change in control of the company.
- 'Phantom' share plans which provide cash payments in similar circumstances.
- 'Cashless exercise' arrangements, provided that the loan used to exercise share options is repaid within 40 days.

Some share plans will not be covered even by the latest exemptions. These may include conditional share awards where the employee does not become entitled to the shares until the remuneration committee or trustee exercises its discretion to release them or until the specified performance targets are met.

■ ■ ■

In cases where the current arrangements do not meet the terms of the exemptions, we recommend that, if feasible, no further action should be taken until further guidance has been issued by HMRC. The terms of new awards can then be adjusted to fit within the exemptions and, for awards which have already been granted, steps taken to minimise the risk of a double tax charge. ■

» About the author

Mike Landon is Executive Compensation Director at MM&K.



Making the connection

Angela Baron takes a closer look at what 'engagement' actually means in a business context.

It has long been argued that engagement impacts on business performance. In 2003, the Chartered Institute of Personnel and Development (CIPD) published the results of its investigation into the relationship between people management and business performance, which concluded that good people management practice results in individuals who are able and motivated. As a result, they exhibit discretionary behaviour described as 'a willingness to go the extra mile' or perform above the required level.¹

The *MacLeod Review*² highlighted how important employee engagement is for organisational success, productivity and performance, and individual employee well-being, and has led to Government sponsorship of an industry-led Employee Engagement Task Force. In recent years, a number of studies have emerged affirming the relationship between engaged employees and business success. Some demonstrate

a positive relationship may exist between levels of engagement and organisational performance metrics such as profitability.³

So, there is now wide agreement that engagement equates to performance. However, many managers are failing to act on this knowledge and, as such, levels of engagement in the UK are relatively low. This indicates that organisations would be significantly rewarded if they got better at understanding and promoting engagement.

Shaping the future

Two years ago the CIPD embarked upon a longitudinal study of the drivers of sustainable organisation performance. *Shaping the Future* aimed to build on current ideas about engagement and identify the drivers of performance over time. Working with six organisations using an action research model it tracked their experiences over three years to identify the challenges they had faced and the creative approaches they had taken

in managing their way through a turbulent economic period. Findings of the first stage of work were published in January 2010 and confirmed engagement as a significant enabler of sustainable performance. All the case studies had implemented strategies to manage or promote engagement as part of their change programmes, and all agreed with the assumption that engaged employees would perform better.

However, a number of observations were made around where and with what in the organisation this engagement occurred. Some employees were only partially engaged with certain aspects of their work, or even actively disengaged in some areas. The survey found that people can be engaged at different levels and with various aspects of the organisation or their work.

Locus of engagement

We defined this phenomenon as 'locus of engagement', which describes 'what' employees engage with and where in the organisation their focus of engagement is located. In some organisations we found employees engage with their business unit more strongly than the wider organisation. In others we found strong team identity and engagement with the customer. While all forms of engagement might be associated with higher performance, we found that engagement with a particular aspect of work might inhibit the individual's willingness to embrace change. We also found that people can be over-engaged with certain aspects of their work, which can damage performance if it makes them less willing to change their work practices. In some of the case study organisations, strong engagement with the customer caused employees to identify more closely with customer needs than with those of the organisation and hence resist changes.

Our research demonstrated that engagement could be transactional or emotional in nature. Transactional engagement is more contractual, with employees prepared to exhibit engagement behaviours as part of their relationship with the organisation and expecting something from the organisation in return. Hence they can quickly turn off their engagement if they perceive they are being unfairly rewarded for their efforts, or identify better opportunities elsewhere. Emotional engagement is more deep-seated, and occurs when people really identify with some aspects of their work and are intrinsically driven to do a good job. High emotional engagement seemed to be more likely when people could identify with the overall purpose of the organisation. These forms of engagement are not mutually exclusive – we identified instances where individuals were emotionally engaged with

some aspects of their work, while displaying transactional engagement with others.

As well as conducting our own research in this area, since 2006 the CIPD has also been working with the Kingston University Business School Engagement Consortium. In the light of our findings, we asked them to mine this rich source of quantitative data to identify any further evidence to support the locus of engagement theory, and to further analyse what this means in practice.

Happily, their data provides rich evidence not only that employees engage with a variety of aspects of their work, but that these vary in intensity over time and affect organisational performance. They found that people primarily engage with their job, and this is the most significant predictor of both performance and citizenship behaviours. As jobs are not static this means that the nature of engagement will vary over time – this needs to be embedded into job design and development programmes.

Engagement is always *engagement with*

something and therefore managers need to understand what it is that people actually engage with. They need to be aware of what the triggers are and ensure that people have the experiences that are likely to foster engagement. Individuals can engage with multiple *loci* at various levels and these are likely to change over time. Managers should understand that engagement occurs within a context, which needs to be managed to



It appears from this work by both CIPD and the Kingston Engagement Consortium that the idea of the *locus* being an important aspect of engagement has largely been neglected by research to date. While this issue will undoubtedly attract further research, we now know that it's important to get behind the engagement score and find out exactly

Engagement equates to performance.

ensure that the conditions for engagement are in place. Finally, perceptions of organisational justice are likely to impact on engagement. Employees are most likely to be engaged with their employers if they believe all stakeholders, including customers, are getting a fair deal. This also extends to the relationships with line managers.

what employees are engaging with. We also know that the things individuals engage with, and to what extent, are influenced by the context in which they are working – environmental factors need to be addressed in any engagement management strategy. ■

» About the author

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Executive decisions



Executive remuneration is in better shape now than before the crisis, but the opportunity to make lasting fundamental changes has been missed, say **Cliff Weight** and **Damien Knight**.

The new UK Corporate Governance Code rightly says that companies should be managed for the long-term. However, this will only be achieved if top executives have

effective incentives that are truly long-term in focus, as well as a major personal investment in their company until such time as they retire or leave. The deferral of large parts of variable remuneration by the banking sector

has been a significant step forward; but other changes there and elsewhere have reinforced the '1-to-3 year' model of performance measurement and remuneration which was exposed in the crisis.

Risk

The financial crisis destroyed some \$2 trillion of shareholder value leading to a hue and cry for retribution, and regulation and remuneration. President Obama cited greed, short-termism and opportunism as the principal causes. In response, the Financial Stability Board of the G20 created new guidelines on bankers' pay that are enshrined in European legislation. Implementation in the UK is via the Financial Service Authority (FSA) Remuneration Code, much of which is concerned with remuneration governance and general policy, with an eye to risk management. In larger banks and other credit institutions, top management and others with a significant risk-impact face rules that constrain the design of their pay packages:

- 50 per cent of variable remuneration has to be paid in retained shares.
- 40 per cent of variable remuneration (60 per cent for directors) has to be deferred over three years, with clawback if performance turns out to have been exaggerated.
- Severe restrictions on guaranteed bonuses for joiners, and on severance payments for poor-performing leavers.
- Significant use of non-financial measures in bonuses.

Despite a popular belief that nothing has changed in bankers' pay, these rules, coupled with recent tax changes, mean that it feels very different for bankers. In the old days in many financial firms a £1 million bonus yielded £600,000 net cash at the end of the year. Now a £1 million bonus might yield only 40 per cent maximum in year one. At the new tax rates that's only £192,000 net pay, with the rest phased over three years. We should not feel too sorry for these bankers – many have had years of high bonuses squirreled away in offshore employee benefit trusts, so as to defer or avoid UK taxation. Those needing cash had access to loans. Bankers' cash flow was also helped by substantial salary increases. Investment bank staff such as dealers, who might previously have been

on £150,000 salaries saw their salaries double to £300,000 or more, ostensibly to comply with an FSA edict to make the package less highly geared.

Following direct and indirect Government support to the sector, most banks' income has improved and many have used their rediscovered prosperity to pay large bonuses, albeit to fewer people. Despite this, the UK banks are concerned that the FSA has been more rigorous in implementing the G20 rules than regulators elsewhere, and some are seriously considering changing location.

There will only be an end to banking pay excesses if a way can be found to change the existing 'ransom' model – where a few talented managers and dealers exploit their position with investment banks, who exploit their position with commercial and retail banks, who exploit their monopolistic position with the rest of us.

Other sectors

In contrast, across non-financial sectors, the financial crisis reduced demand, increased the cost and availability of debt funding, and led to reduced profits. Alignment of remuneration to good risk management was the last thing on the minds of most of these companies. Commonly, salaries were frozen and bonuses reduced. The priority for most companies has been surviving while trying to retain their best people in order to take advantage of the recovery when it eventually arrives.

Many companies had variable pay programmes – these were well-placed to help companies respond to the crisis, by rewarding the perceived business priorities as at each stage of the crisis. It is notable, however, that the changes imposed on banks and credit institutions are now being seen by institutional shareholders and corporate governance commentators as representing 'best practice' for other industries as well. In our view companies need to consider very carefully the relevance of these measures

the fiscal gap in ways that get popular support. These changes include:

- the 'temporary' increase in personal taxes to 52 per cent including National Insurance contributions;
- tightening up 'disguised remuneration';
- the tapering out of pensions tax relief and personal allowances for high income earners; and
- the dramatic reduction in the annual allowance for tax-privileged pension saving.

From April 2011, these changes will reduce the cost of pensions tax relief by about £4 billion per annum. Shareholders have insisted that executives are not compensated for these additional tax burdens.

Defined benefit plans continue to fall away. A few older chief executives still have defined benefit pension promises, but most internal promotions to board roles and new hires have a defined contribution plan. In future the norm will be to have a tax-effective pension contribution up to the annual allowance, and then a cash 'pension' allowance on top of this.

Defined benefit plans were very effective at retaining and rewarding high performers who gave long service via salary increases, but which had a disproportionate knock-on pension benefits. New ways to reward such executives may need to be developed.

Other trends

Swap of long-term incentive into bonus

Deferred bonus plans are now commonplace. Over 50 per cent of FTSE 100 companies have such plans, up from virtually none ten years ago. These typically require deferral of 30–50 per cent of the bonus into shares for a period of three years. Universally, the introduction of deferred bonus plans has been accompanied by an increase in bonus opportunity. Often this has happened alongside a reduction in long-term incentive plans (LTIP) grants, and there is good evidence that companies

to measurement over a vesting period of at least three years. And yet a deferred bonus plan, introduced alongside increased bonus opportunity, is effectively an LTIP performed at grant.

Use of multiple measures

FTSE 100 companies have increasingly used multiple measures (e.g. scorecards that record multiple targets that must be met) for their bonus plans. Two-thirds of companies have four or more measures, which contrasts with only a quarter of mid-cap 250 companies. This change has increased the chances of getting at least some payout and, despite the credit crisis, the volatility of bonus payments in the FTSE 100 has reduced. Bonuses are a better bet for executives, since they stand a greater chance of being paid out – the benefit to shareholders is more questionable. The FTSE 100 has led on these changes and the mid-cap 250 is catching up.



So where do all these changes get us? The corporate governance machinery in the UK is congratulating itself on reducing the risk in remuneration in banking and spreading best practice lessons to other sectors. But we at MM&K think there are inherent faults in the emerging model and a real opportunity for change is being missed.

Remuneration committees, under pressure from all sides, are becoming increasingly conservative. As a result, they often look outside for 'best practice' rather than designing tailored remuneration plans which drive value and performance. The 'best practice' model that has emerged is horrendously short-term. The timescale for incentive measurement for bonuses and LTIPs is one to three years. The use of deferred bonus plans has further shortened the timescale of performance measurement. This reflects the systematic short-termism amongst most investors as well as the media. Chief executives are expected to 'do something' to get results in the short-term. Share options are now sadly neglected, despite the fact they potentially create an interest in the share price for up to ten years.

Hopefully Vince Cable's consultation on long-termism in business in the UK can help to reverse this trend and help persuade companies that the high short-term gains, though more lucrative, are not as rewarding as a well-thought-out remuneration programme that tie more moderate gains to long-term success. ■

The changes imposed on banks are now 'best practice' for other sectors.

to their particular sector, and consider in particular the negative effects they could have on motivation and performance.

On top of the lingering direct effects of the crisis, changes in remuneration practice have been taking place against a background of fundamental changes in income tax rules. These changes are largely a consequence of the credit crisis, as successive governments have sought to fill

have been swapping LTIP grants for deferred bonuses as a more predictable way of delivering share participation to executives. However, there has been some sleight of hand here. Successive Association of British Insurers guidelines clearly stated that LTIP and share option 'performancing' (i.e. awarding shares in the future based on performance at the time of granting) at the point of grant is not considered a suitable alternative

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Diamonds in the rough

Phil Hall asks whether it is time that the Government polished up the ageing regulations around all-employee share plans.

Save As You Earn (SAYE) and Share Incentive Plans (SIPs), the HM Revenue and Customs-approved all-employee plans, celebrated their 30th and 10th anniversaries last year. It is therefore timely to ask whether the existing approved share plans could be improved to deliver even better results in the fast-changing world in which we now live.

A wealth of UK and international evidence suggests that employee share ownership

can lead to higher productivity and financial performance, greater innovation, lower staff turnover and improved employee advocacy; all of which benefits the employer, the wider economy and society as a whole.

Employee share ownership can also be of tremendous benefit to the individual employee. Over the past 30 years, approved employee share plans have proved to be a very useful, simple and tax efficient savings and share acquisition

mechanism for employees on a wide range of incomes – thus encouraging medium and long-term saving and benefitting millions of individual workers.

It could be argued that there is no need to change a system that has so many proven benefits. The counter argument, however, is that change is essential if we want to ensure these benefits are maintained or, better still, spread more widely. Put simply, two changes need to occur: the number of employers offering employee share plans needs to increase, as does the number of employees participating in such plans.

Rewards

Recent research by ifs ProShare suggests that there has been a year-on-year increase in the number of companies offering HM Revenue & Customs (HMRC) approved all-employee share plans in recent years. The majority of FTSE 100 companies offer an approved employee share plan, and a large number of the FTSE 250 do too. Yet for a variety of reasons a significant number of large companies still do not offer these proven rewards.

As large listed companies move increasingly towards executive share plans, rather than cash bonuses, for senior executives (most

notably in the financial services sector under the direction of the Financial Services Authority) it would make sense for companies to take a company wide look at the rewards package offered to all employees.

While trying to ensure as many listed companies as possible provide an all-employee share plan, a real step change in participation rates would require real reform. A step in the right direction is the Postal Services Bill, the legislation that enables the privatisation of Royal Mail. The legislation includes a commitment to allocate at least 10 per cent of the shares in a privatised Royal Mail to its employees. The legislation doesn't specify what form this share allocation should take – and we have made clear our desire to see HMRC approved all-employee share plans on offer – but it has served as a very useful vehicle by which to draw attention to the benefits of employee share ownership to a company, and thousands of workers, previously unable to benefit from employee share ownership.

There are many other companies that could similarly benefit but are prevented from doing so by outdated legislation. For example, private equity-backed companies. At present, employees who work for companies backed by private equity are prevented from participating in HMRC approved share plans.

Indeed, many companies that are now private equity-owned used to operate approved share plans before they were acquired, for example, house builder Crest Nicholson and high street retailers Debenhams and Boots. Such changes of ownership means tax-approved plans become immediately unavailable resulting in an abrupt and acutely-felt loss to their employees. There are also companies which have always been backed by Private Equity who, by virtue of their ownership model, have never had the opportunity to allow their staff to share in their success through employee share ownership.

The UK private equity industry is the largest and most developed in Europe. A British Private Equity and Venture Capital Association (BVCA) report published in 2007 suggested that companies who had received private equity funding accounted for the employment of around three million people in the UK, equivalent to 16 per cent of the UK private sector employees. That means more than 10 per cent of the private sector workforce is denied the opportunity to have a stake in their employer's success. These companies, employees and the economy as a whole are weaker as a result.

Whether or not Royal Mail, other publicly owned bodies soon to be privatised or private equity backed companies do offer approved plans in the future, existing HMRC approved all-employee plans need tweaking

to maximise their effectiveness and ensure they remain fit for purpose.

Holding

For instance, one practical step would be to reduce the SIP holding period from five years to three. Many employees, particularly those who have not participated in a scheme before, choose to participate for the shortest length of time. This is demonstrated by the fact that well over 60 per cent of SAYE share plan participants are enrolled in a three year plan, compared to less than 1 per cent

lowest level of gross savings as a percentage of GDP in Europe, better only than the likes of Greece, Ireland, Portugal and Iceland.

Encouraging greater levels of employee share ownership would help raise the national savings ratio, especially if the amount of money that can be saved in all-employee plans were to rise. This is true of SIP, but is especially true of SAYE, where the £250 a month savings limit has not been increased for more than 20 years. Had the £250 limit risen in line with inflation, the maximum monthly contribution allowed would now be

Change is essential if benefits are to be maintained.

for seven year plans. However, this does not mean that employees only save for the minimum three-year period. Many employees go on to participate in another scheme at the end of the three-year period as they will have experienced the benefits of participation and have adopted the savings habit.

Removing this anomaly would also better reflect the trend toward increasingly mobile employment of the UK workforce. According to the Office for National Statistics, the median job tenure was 61 months in 1996, it had fallen to 48 months by 2001 and is doubtless even shorter now. If we are serious about encouraging greater employee participation, then this is one practical way that it could be achieved.

Of course, making such alterations would be much easier if it did not require changes to legislation. At present, this necessitates finding a slot in a packed parliamentary timetable amongst numerous other competing interests. If all-employee plans were treated in the same way as Individual Saving Accounts (ISAs) regulations then changes could be made more speedily, with less cost and less bureaucracy. This simplification measure is something we are currently investigating with HMRC. Had changes to regulations rather than legislation been required in relation to recent disguised remuneration issues then 60 pages of amendments to the Finance Act 2003 might not have been required – another strong argument for change.

Companies and policymakers also need to focus much more on the savings and wealth creation benefits of employee share ownership and make sure these are appropriately communicated to, and understood by, employees.

There has long been a need to foster a better savings culture in the UK. According to the World Bank we currently have the fifth

approximately £450. In our opinion it should be increased immediately and rise in line with inflation on an annual basis. A 2008 survey of ifs ProShare members indicated that 20 per cent of SAYE participants are investing the maximum £250 a month and, although not all of these employees would increase their savings to a new limit of £450, there can be little doubt that many would.

It could be argued that the average amounts saved in SAYE plans are well below the maximum – the ifs ProShare annual survey for 2008 showed that SAYE participants saved £82 on average, the 2009 survey figure was £110 – and we expect the 2010 results to be broadly similar. However, if Government policy is to focus solely on averages, then the needs of many thousands of employees would be ignored and a perfect opportunity to boost savings levels would be missed.



Employee share ownership has benefited millions of UK employees, thousands of employers and the UK economy as a whole. We need to redouble our efforts to make sure this success story continues. The improvements we have described above would have relatively small cost implications for the taxpayer and would allow the Government to demonstrate and reassure the business community that it is serious about supporting employee share ownership.

More importantly, making these changes would open up more opportunities for employees to become engaged with their employers, improve their productivity levels, save for their futures and purchase shares – aspirations I think we all share. ■

» About the author

Phil Hall is the Head of ifs ProShare.

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