

Is pay racing away again?

We did not expect the AGM season to be particularly dramatic and it has so far only yielded very few, and fairly minor, public skirmishes involving companies and their shareholders. Investors have continued to react against one-off incentives and there has been some concern expressed that a few companies' incentive plans are not challenging enough. However, most interesting is that the threat to look closer at levels of pay has begun to be translated into some action – or, at least, into a number of Association of British Insurers (ABI) red-topped and amber-topped verdicts and some recommendations to vote against Remuneration Reports from Research Recommendations Electronic Voting (RREV). Indeed, what we continue to hear from investors, both openly in the press and from private ongoing dialogue, is that upward ratcheting of pay is the most serious concern they have overall.

To test whether the concern stems from isolated cases or a general trend, we examined the report and accounts of 53 FTSE100 companies with December 2006 or January 2007 year-ends and that had published at the time of us going to print. This is a brief summary of our findings, and we will publish a much fuller account of the latest FTSE350 trends in our annual FTSE350 Directors' Compensation Survey this autumn.

Base Salaries

Salary increases awarded to FTSE 100 executive directors in our sample have been very similar to last year's increases, remaining conservative from an historical perspective but still at a median rate above both annual inflation (4.4%¹) and general pay increases across the United Kingdom (4.8%²). For reference, the FTSE100 Index increased by 10.7% during 2006. The table below summarises the salary increases awarded to executives who stayed in the same position for two consequent financial years – i.e. matched sample of individuals, excluding joiners and leavers.

	Lower Quartile		Median		Upper Quartile	
	2007	2006	2007	2006	2007	2006
Chief Executives	3.7%	4.7%	6.4%	6.8%	9.3%	10.0%
Finance Director	3.9%	4.0%	6.5%	7.7%	12.5%	10.2%
Other Directors	3.0%	4.3%	5.4%	5.9%	8.6%	12.1%

Including all sample companies, factoring in the impact of new joiners (and leavers), increases in salary benchmarks are a little higher at the median. The following table summarises our findings.

	Lower Quartile			Median			Upper Quartile		
	2007	2006	Increase	2007	2006	Increase	2007	2006	Increase
Chief Executive	£624,000	£619,000	0.8%	£840,000	£775,000	8.4%	£919,000	£858,000	7.1%
Finance Director	£377,000	£370,000	1.9%	£452,000	£422,000	7.1%	£560,000	£510,000	9.8%
Other Directors	£324,000	£311,000	4.2%	£439,000	£427,000	2.8%	£538,000	£500,000	7.6%

In particular it is interesting to note that both sets of statistics show a faster pace of increases at the median for Finance Directors compare with other directors.

¹ Percent change in Retail Prices Index to December 2006 (Source: National Statistics, May 2007).

² Percent change in Average Earnings Index: whole economy over 12 months previous to Jan-07 (Source: IDS, Executive Compensation Review, May 2007).

Total Compensation

Total compensation levels, including base salary, annual bonuses and the expected value of long term incentives³ granted during the reported year as expected rose more than base salaries.

When comparing a matched sample of individuals (those staying in the same position for two consequent years) the changes in total compensation were as follows:

	Lower Quartile	Median	Upper Quartile
Chief Executive	1.0%	16.6%	26.0%
Finance Director	6.2%	12.6%	30.6%
Other Directors	0.3%	10.0%	31.0%

The actual total compensation levels per position were as below:

	Lower Quartile			Median			Upper Quartile		
	2007	2006	Increase	2007	2006	Increase	2007	2006	Increase
Chief Executive	£1,621,000	£1,596,000	1.6%	£2,532,000	£2,456,000	3.1%	£3,878,000	£3,492,000	11.1%
Finance Director	£1,020,000	£998,000	2.2%	£1,711,000	£1,403,000	22.0%	£2,026,000	£1,856,000	9.2%
Other Directors	£913,000	£852,000	7.2%	£1,526,000	£1,358,000	12.4%	£1,884,000	£1,748,000	7.8%

It is again notable that the range of increases for Finance Directors is generally higher than Chief Executives and other directors, in some cases resulting in a narrowing of the gap between them.

In conclusion, compensation for FTSE100 executive directors is continuing to rise but, apart from some adjustments, there is little evidence of it racing away. It remains, of course, for Remuneration Committees and investors to be satisfied that levels of pay reflect performance.

³ For each company we have added in all the grants made to directors under all its long term incentive plans (including share options plan, performance shares, deferred annual bonus plans, and co-investment plans) and have valued each award individually, taking into account company specific parameters such as share price volatility, dividend yield and the specific performance condition governing the vesting of the awards.