

Embargoed until 00.01, Mon. 4 February 2008

## **Performance-related pay schemes should incentivise directors to manage non-financial risks**

1. Performance-based pay for executive directors is not tied closely enough to management of non-financial business issues, research by the Local Authority Pension Fund Forum (LAPFF) has found.
2. Under the Companies Act 2006, companies are now required to identify key performance indicators (KPI) that the company uses to measure its non-financial issues such as health and safety, employee relations and environmental management. In a baseline study of the linkage between remuneration and non-financial performance in the FTSE 100, the Forum found that two thirds (66) of the companies in the FTSE 100 disclose at least some type of non-financial KPI.
3. However, the study reveals that only seven companies consider non-financial performance measures important enough to build them into a long-term incentive plan (LTIP), the main tool used to motivate executive directors to achieve high performance.
4. Creating sustainable shareholder value means building on good financial and non-financial performance. LAPFF believes that executive incentive schemes that only measure performance against financial targets do not adequately focus executive directors' minds on the non-financial factors that influence a company's long-term prospects. Investors should question companies' KPI-and target-setting processes, and encourage greater coherence between business review KPIs and remuneration targets.
5. The situation is more positive when annual bonus schemes are considered. The Forum's research found that approximately half of the companies in the FTSE 100 operate annual bonus schemes that apply non-financial performance measures alongside more traditional financial targets. However, at only one of these companies do non-financial factors account for 50% or more of the maximum bonus potential.
6. United Utilities is the only company in the FTSE 100 with an LTIP that employs more than one non-financial performance measure. Its Share Matching Plan focuses on performance in four different operational areas: quality and environment, customer service, efficiency and finance, and employee satisfaction/engagement.
7. Cllr Ian Greenwood, newly elected chair of the Forum, said: "It is encouraging that an increasing number of companies are tying directors' rewards to non-financial factors, since these can be fundamental to business success over the long term. But there is still much work to be done: If a company thinks non-

financial factors are important enough to identify as key performance indicators in its Business Review then it clearly makes sense for executive incentive schemes to incentivise directors to obtain high performance in these non-financial performance areas.”

### **Notes to the editor**

1. The Local Authority Pension Fund Forum (LAPFF), which was set up in 1991, is a voluntary association of 46 public sector pension funds based in the UK. It exists ‘to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.’ The Forum’s members currently have combined assets of over £85 billion.
2. In 2007 the Forum called on its members to oppose BP and Shell’s remuneration reports due to the lack of safety targets (and, in the case of Shell, lack of climate change targets) under their LTIPs.
3. In 2008, the Forum will continue its engagement campaign to encourage companies to accept non-financial performance measures as worthy partners of more traditional performance targets, and to demonstrate their commitment to non-financial key performance indicators by formally embedding them in executive long-term incentive schemes.
4. The Forum’s research is available from the website, [www.lapfforum.org](http://www.lapfforum.org), under ‘Publications’.

### **For further information contact:**

Cllr Ian Greenwood, Chair, LAPFF  
C/o LAPFF Secretariat,  
Bradford City Council,  
Britannia Ings, Bradford,  
Email: [ian.greenwood@bradford.gov.uk](mailto:ian.greenwood@bradford.gov.uk)

Ebba Schmidt  
Consultancy Services Executive  
PIRC Ltd  
Tel no: 020 7392 7876  
Email: [EbbaS@pirc.co.uk](mailto:EbbaS@pirc.co.uk)

or Susanna Rust  
Research Executive  
Tel no: 020 7392 7888  
Email: [SusannaR@pirc.co.uk](mailto:SusannaR@pirc.co.uk)