Dear Rachel,

Thank you for the opportunity to give evidence to the Select Committee on the subject of executive pay. This is an important topic of public trust in business and so I was delighted to have the opportunity to be of service to the Committee. I have been in discussion with Chris Shaw and requested that he circulates this letter to the whole Committee.

I agreed to provide additional detail about the remuneration structure of the Weir Group PLC Chief Executive Officer (CEO). As published in the Group’s 2017 Annual Report, the Group’s CEO received a base pay of £650,000 in 2017. The CEO’s single total figure of remuneration for 2017 was £1,440,927 including pension contributions, benefits and annual bonus. Full details of the Group’s remuneration policy are available at www.investors.weir.

I also want to take the chance to share some further reflections in my capacity as Co Chair of the Purposeful Company Taskforce. This is a consortium of leaders from across the investment chain actively working to transform British business with purposeful companies committed to creating long-term value by serving the needs of society. Having now had the opportunity to view the second evidence session, it is clear that much of the debate comes down to what companies, shareholders, and policymakers should be doing about levels of executive pay, which are perceived to be too high.

As I touched on in my evidence to the Select Committee, remuneration committees face a particular dilemma in fulfilling their fiduciary duty to act in the long-term interests of the company. On the one hand they need to ensure that they pay enough to attract and retain top quality executives to lead the company to long-term success. On the other, they need to take into account the real public concern about levels of pay, recognising that this can damage the licence to operate of all companies. This is not a dilemma that can be solved to the full satisfaction of all parties, but what I want to emphasise in this letter is that pay reform, along the lines recommended by the BEIS Committee, and as implemented in the Weir Group, can go a long way.

The market reality that remuneration committees face is that executive pay for the majority of public companies in the UK is not out of line with international norms for companies of comparable size, and is indeed below US levels. Nor is it above (or in some cases even as high as) what people earn in a range of scarce skill occupations in the UK such as media, entertainment, sports, professional services, and, most importantly, many areas of private business. The growth in CEO pay, which in the last 35 years most strikingly took place between 1998 and 2007, can be shown to reflect both the increase in size and complexity of large companies in the UK, and to be in line with a broader trend of growing wage inequality across the economy. Non-executive directors, who have a fiduciary responsibility to attract and retain executives to run companies, cannot ignore these market realities.

On the other hand, the impact of executive pay on trust in business, and the impact of wage inequality on social cohesion, raises genuine concerns that cannot be ignored, and in my experience the boards I have served on are acutely aware of this issue. The challenge for directors of public companies is how to balance these very real concerns with competitive market realities, when executives in many businesses have genuine choices about, in particular, whether they work in public or private companies. Many of us on remuneration committees seek to apply the maximum restraint on pay. As I conveyed in my evidence, this is resulting in base salary rises that are routinely pegged to those of the wider population or below, and increases in potential incentive pay are increasingly rare. However, while this is leading to executive pay no longer increasing (on robust bases of analysis it has been broadly flat since the financial crisis) it is also clearly not decreasing, other than at the extremes. Furthermore, it cannot decrease markedly, without damaging listed companies, while pay levels in comparable roles in private companies or in other countries are as they are.

Market forces and fiduciary duties relating to executive recruitment and retention mean that significant changes to pay relativities are unlikely to be realised through further shareholder powers, registers, or disclosures that affect just listed companies. To address wage inequality, which is an economy-wide phenomenon, will require policies in the areas of taxation, minimum wages, productivity, skills, and education. It will also require Boards to be active in ensuring that there is an opportunity for all employees to share in business success. As I shared with the Committee, this is one of the reasons the Weir Group sought approval from shareholders this year for a new All-Employee Share Ownership Plan.

The most responsible action remuneration committees can take, consistent with their fiduciary responsibilities, is to ensure that executive pay is simple, transparent, truly long term and linked to performance. Designed in this way it encourages the right rather than wrong behaviour. Given the sums involved, it is clearly important that the
incentives are right, and too many recent business problems seem to have flawed incentivisation playing at least a contributory role. Therefore, at Weir we fully endorsed and enacted the Committee’s previous recommendations on implementing restricted stock with vesting over 7 years in place of LTIP.

Not only does this encourage the right long-term behaviour, and discourage short-term behaviour, it also reduces maximum pay significantly, and avoids the risk of unexpectedly large pay-outs that cannot be explained to the external world. This is why I strongly believe that the goal of promoting reform in pay design is critical, and provides a practical way forward to make a difference in what is a very challenging area for business. Making it easier for other companies to follow this lead is an area where political signalling power from your Committee, and from Government, can be very powerful.

As part of our work on the Purposeful Company Taskforce we have reviewed a wide range of the best academic evidence in support of these conclusions. We have provided summaries of this evidence in our submissions to the Committee over the last 18 months, and I would be happy to make members of the Taskforce available to talk these findings through with you in more detail at your convenience, if that would be of help.

Yours sincerely

Clare Chapman

Cc: Chris Shaw, Clerk, Business, Energy and Industrial Strategy Committee.