



LEC NO

Prime Minister²

Treasury Chambers, Parliament Street, SW1P 3AG
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30 March 1983

The Rt. Hon. Patrick Jenkin MP
Secretary of State for Industry

Patrick Jenkin

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BRITISH STEEL CORPORATION:

PERFORMANCE-RELATED PAY FOR BOARD MEMBERS

Thank you for your letter of 22 March containing proposals for a performance-related pay scheme for members of the BSC Board.

I welcome these proposals. As you say, the BSC Board is a suitable candidate for performance-related pay because of its competitive environment. With the desirable reduction in the maximum bonus to 25 per cent of basic pay which you suggest, I consider, subject to what follows, that the BSC scheme would be justifiable even if basic salaries were at levels that the BSC Salaries Committee would consider satisfactory.

I have only one significant reservation. Under the proposed scheme, precisely meeting the budget would merit a payment of half the maximum bonus. This is too much. In my proposals to E(NI) I suggested that bonuses should be earned mainly for better than standard performance. I accept that meeting the budget deserves some reward but most of the bonus should only be awarded for the achievement of figures above budget. In the nature of the scheme the precise sums will have to be left to the judgement of the Salaries Committee, but the Committee should be asked to think in terms of awarding less than half of the maximum bonus for just meeting the budget.

I am pleased that you have decided that bonus payments should be non-pensionable. I accept that if necessary you might offer to review this at a later date.

I note that you will be giving the new Chairman of BSC a chance to comment on the scheme before authorising its implementation. I would be glad to know in due course whether you intend that the new Chairman should himself be included in the scheme (as the Salaries Committee recommended in principle).

I am copying this letter to other members of E(NI), to John Sparrow and to Sir Robert Armstrong.

Geoffrey Howe

GEOFFREY HOWE

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Pt 2



30 MAR 1983



Secretary of State for Industry

The Rt Hon Geoffrey Howe QC MP
 Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 London SW1

Dear Geoffrey,

BRITISH STEEL CORPORATION: PERFORMANCE-RELATED PAY FOR BOARD MEMBERS

In May last year, with your agreement, I invited Albert Frost and the two other BSC non-executive directors who make up the Salaries Committee to draw up proposals for a performance-related pay (PRP) scheme for executive Board members. They responded by submitting a paper to me at the end of September, a copy of which I attach. Detailed consideration was deferred during the strategic review of the Corporation's major plant configuration which had to be undertaken at the end of last year. Now that is over and E(NI) have also considered the general issues surrounding PRP arrangements (at our meeting on 14 March), I think the time is ripe to put the BSC scheme to you and to recommend the basis on which it should be approved.

2 I start from the premise that BSC is a suitable candidate for PRP. The Corporation operates in a fiercely competitive market. The difficulties which it faces - in restructuring, manpower slimming, optimising output and so on - are formidable and impose heavy strains on senior management. Nor are present Board salaries so generous that some enhancement through PRP would be embarrassing - at the beginning of 1982, the Salaries Committee were arguing that increases of up to 100 per cent would be necessary to achieve realistic pay levels and we have of course been unable to offer anything approaching that sort of increment either then or since.

3 As to the shape of the scheme which is being proposed, it was of course drawn up before the NICG/official group on PRP carried out its work and reported to you in December. Nonetheless, I believe that the BSC proposals are not only appropriate to the circumstances of the Corporation but also broadly in line - save in two respects which I shall comment on later - with the main conclusions which emerged from the NICG/official group's work and from our discussions in E(NI).

DEPARTMENT OF INDUSTRY
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22 March 1983

Prime Minister

Mr Jenkin plans to introduce a
Performance-Related pay element - of
 up to 25% - for BSC Board Members.

MUS 22/3



- For a PRP scheme to be acceptable, it seems to me that the main requirement is that the criteria for assessing performance should represent a sensible mixture of the qualified and judgemental (as you recognised in your recommendations to E(NI)). I think the BSC proposals fit this bill. Bonus payments would be assessed on performance in achieving the detailed budget targets which flow from the annual Corporate Plans. These are approved each year, first by the BSC Board and then by the Government, as short-term goals consistent with the longer-term framework of objectives which we have set for the Corporation. The main criterion for judging performance would be achievement of profit/loss targets, with due regard also being paid to the important area of cash control. The precise weighting between the two, and any adjustments to the budget targets made necessary by a significant change in circumstances during the year in question, would be decided by the Salaries Committee.

5 The Committee would also decide each year on what should constitute a "significant" improvement or shortfall against budget, so justifying a maximum or minimum payment, and how results in the intervening range should be rewarded. In reaching this decision, the Salaries Committee would also take some account of other factors, both quantitative and qualitative, which they judged relevant. The paper mentions morale as one example. More importantly, however, Mr Frost has made clear to me separately that the qualitative element of this assessment might be used to encourage management to act in the longer term interests of the business as a whole. And he cited specifically the possibility of rewarding actions which involved the transfer of some part of BSC to the private sector, even at some immediate cost in cash or revenue, in furtherance of a clear policy on privatisation. This could form a useful extra spur to the achievement of our policies in this area and I would propose to ask Mr Frost to incorporate it in the scheme.

6 There are two areas, however, where I think the proposals need to be altered. First, the maximum bonus of 40 per cent not only looks too high against the background of the limited pay increases granted to the workforce as a whole in recent years but also seems primarily a device for overcoming deficiencies in basic pay (a distortion of PRP which we have agreed to reject). I therefore propose that we should set a maximum of 25 per cent. Secondly, I would be prepared to follow your general recommendation to E(NI) that bonus payments should not be pensionable, though we might offer to reconsider the position at a later date once we and BSC have experience of how the scheme as a whole works in practice.

7 Finally, there is the question of the starting date. Mr Frost had proposed 1982/83 as the first year of operation but has since accepted my view that this would be very difficult against the background of the major divergence from Plan targets which has occurred this year. Subject to what follows, 1983/84 would seem preferable.



8 I should be grateful for your approval of the scheme in principle on the basis outlined above so that I can let Mr Frost know our reaction to his proposals. I would not, however, propose to give BSC the final authority to implement it until I have given whoever is to be the next BSC Chairman a chance to express a view. If he has comments of substance on what is proposed, then I would of course come back to you. If not, then the scheme could go ahead. But I do not think that this need delay our reaching a view between ourselves on the merits of the scheme.

9 I am copying this letter to other members of E(NI), to John Sparrow and to Sir Robert Armstrong.

Your
Patric

B.

BRITISH STEEL CORPORATION
PERFORMANCE-RELATED SALARY PAYMENTS
FOR EXECUTIVE BOARD MEMBERS

Note for Secretary of State

Introduction

In response to an invitation from the Secretary of State for Industry, the BSC Salaries Committee undertook to propose a performance-related salary payments scheme for executive Board Members. (In principle, the scheme should apply to the Chairman also, but the present Chairman does not wish to benefit from the scheme).

2. The Committee has decided that it is undesirable for the four executive Board Members to participate in a scheme confined to themselves only. The scheme would therefore also include BSC's Managing Directors, i.e. the individuals (at present numbering eleven) at the level immediately below Board Member: unlike Board Members, the MDs' salaries are, of course, not subject to determination by the Government. All BSC employees below that level already have some element of their pay dependent on business results.

3. Performance-related payments under such a scheme would be related to the performance, in the previous financial year, of the Corporation or of the particular Business within the Corporation for which the individual is responsible. The payments would be awarded annually, as lump-sum percentage additions to the individual's 'basic salary'. Payment would be made as soon after the end of the financial year as the business results had been finally determined in the BSC's management accounts. The payments would be pensionable.

4. The 'basic salary' to which the performance payment would be added would be the individual's earnings (excluding any performance payment) received from BSC during the financial year to which the performance related. This basic salary would have included any advancement made by the individual during the year within the approved salary ranges under the separate arrangements already existing and assumed to continue.

Outline of Scheme

5. The performance-related payments would be determined each year according predominantly to the achievements of the particular Business to which each Member's/MD's responsibility relates. Thus the achievements of BSC

as a whole would determine the payments for the Chairman, the Deputy Chairman and the MDs with functional responsibilities (whether or not a particular MD was also a Board Member). The payments for Group Chairmen and Business MDs would be determined as to 80% by the performance of their respective Group or Business but as to 20% by the performance of BSC overall (since it is desirable for these individuals to be motivated not only by the results of their own Business but also, to some extent, by the effect of these results on the overall result).

6. The size of the payments would depend essentially on the achievements as compared to the 'budget' figures as finally approved by the Board (usually in April each year), and as notified at that time to the Secretary of State. These budget figures would be related to the figures in the Corporate Plan presented to the Government in the previous December, but not necessarily identical (particularly as regards each constituent Business's share of the total, for they would be updated figures). In making the comparison between achievement and budget, the Salaries Committee would need to decide (if necessary on advice, e.g. from BSC's auditors) whether any special adjustments should be made to the budgets originally adopted. For example, adjustments might be justified on account of part or all of the contingency allowances that had been identified, at the start of the year, outside the budgets; or on account of additional cash needs arising during the year from Government requests made after the cash budget for the year had been settled (cf. the 'Phoenix' arrangements in 1981/82).

7. The scheme would begin in the year 1982/83, i.e. the payments to be determined and made in May/June 1983 would relate to the achievements in 1982/83 as compared to the budget for that year.

8. The Committee considers that initially the maximum performance-related payment should be 40% of basic salary (even though this would still leave BSC Board Members' total remuneration well below market levels - see para. 11 below). Within this maximum, the performance-related payments would be on a sliding scale according to the amount by which BSC or the Business had in the event exceeded or fallen short of its budget figures. While some qualitative criteria would be taken into account, the broad effect would be that meeting the budget precisely would merit a payment of 20% of basic salary;

improving significantly on the budget would merit the maximum payment of 40%; falling significantly short would merit no payment; and results at intermediate points would be rewarded pro rata. (How a "significant" variation should be determined is discussed in paras. 13 and 14 below).

9. The contrast might appear to be very marked between a maximum payment of 40% for this small group of top management and the payments at present made available to BSC employees generally under the existing lump-sum bonus schemes. The latter have averaged around 5-10% and the maximum ever paid has been 16%. However, up to 25% of the basic pay (excluding the lump-sum bonuses) of most of BSC's production employees is already geared to results in one way or another, and BSC's policy is to extend this feature in the pay structure of these and other grades of employees, including management.

10. It is nevertheless true that the total extra remuneration of the top management covered by the proposals in this paper would, if performance warranted it, represent a much greater percentage increase over present levels than would apply to other BSC employees. BSC (and perhaps the Government) would need to reply to any criticisms of this kind by stressing that the gap between present pay and market rates for the top management covered by the proposed scheme is greater than in the case of the senior management generally and very much greater than in the case of junior management and industrial grades.

11. Even the maximum performance-related payment of 40% proposed in this paper would leave Board Members' salaries well below the level considered by the Committee to be justified by the market, as explained in its memorandum to the Secretary of State of February 1982. However, it is considered to be a reasonable figure for the first year of the scheme, particularly since it will be reviewed by the Committee in 1983.

12. The Committee has considered various criteria for measuring performance for the purposes of the performance-related payments. The best indicator of success is profit/loss, but another important indicator is cash - even though both of these depend greatly on factors (particularly price) largely outside BSC's control. The Committee therefore considers that performance on profit/loss, as compared to budget, should be the main criterion used, but that due regard should be paid to performance on cash, again as compared to budget. The weighting as between the two would be decided each year by the Salaries Committee - within the initial maximum of a 40% payment for any individual.

13. The Committee would also decide each year, for BSC and each constituent Business concerned, what constituted a 'significant' improvement on budget, both on profit/loss and cash, warranting the maximum overall payment of 40%; what constituted a significant shortfall, warranting a nil payment; and how results in the intervening range should be rewarded. In exercising its judgment on this, the Committee would also take some account of other relevant factors, both quantitative and qualitative, including the state of morale in the Business concerned. Its conclusions, insofar as they related to the salaries of Board Members, would be reported to the Secretary of State in the same way as already applies to movements of Members' salaries within the approved ranges.

14. It may be argued that the size of performance payments should be related to performance measured by a more or less automatic mechanism, rather than leaving this entirely to the judgment of the Salaries Committee as proposed. In a normal business situation some formula could certainly be devised which would show what actual profit/loss or cash performance represented a sufficiently significant improvement over budget (or shortfall below budget) to warrant the maximum (or a nil) performance payment - although even this would require some judgmental input. If the Corporation's present profitability were closer to that of industrial companies generally, such an approach would have attractions. But initially, in BSC's present loss-making situation, the Committee believes that there is no satisfactory substitute for relying on its own judgment. The correction of heavy losses calls for much more demanding management effort than the improvement of profit, and this effort would be particularly difficult to measure mechanically in advance. The Committee will, however, keep this aspect under review and consider how far a more automatic mechanism should be adopted, as the Corporation returns to profitability.

Future Review

15. The scheme as a whole would be reviewed by the Salaries Committee in 1983, in the light of its first year of operation. The review would cover not only the level of maximum payments (i.e. whether to raise the 40% figure proposed for the first year), and the case for greater "automaticity", but also all other aspects of the scheme.

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22 MAR 1983