Out with the old

The recent debate over limits on executive pensions has raised both the prospect of a stampede for the exit door by senior staff and the interest in talent management for the next generation. By Jane Simms

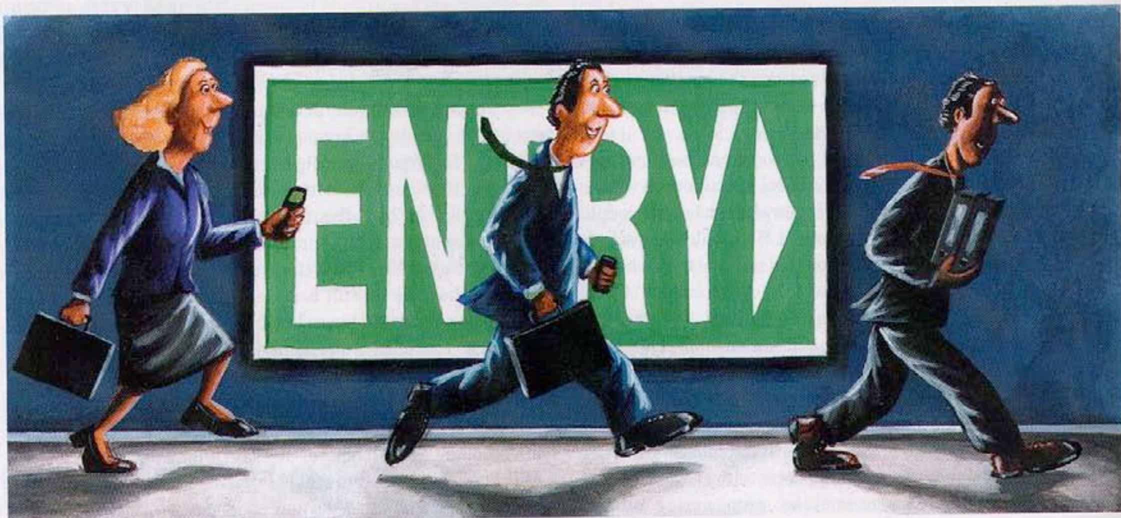
'Equating grey hairs with leadership ability is a dangerous premise,' points out Roger Evans, UK director of coaching, at DBM's Centre for Executive Coaching. It may be dangerous but it is common nonetheless. 'When we ask fast-trackers which of their bosses they aspire to, most have difficulty citing anyone at all,' continues Evans. 'There is a dearth of top role models and companies should spend more time developing younger leaders than trying to retain old ones.'

The likely impact of the Government's decision, confirmed in the March budget, to restrict the tax-sheltered value of an individual's pension pot to £1.5 million, means this is particularly relevant today. Some believe it will have wider and potentially more damaging implications for companies and their employees than the Government would have us believe.

Around half the respondents to a survey of FTSE 500 companies carried out for KPMG believe the cap will affect companies' executive development and succession planning strategies, with 64% expecting the change to prompt some senior managers to retire early. As Sean O'Hare, KPMG's head of executive compensation, puts it: 'This could lead to a more fluid job market given that the current retention tool of a defined benefit plan for executives will effectively disappear.' The fear is that executives approaching retirement will not want to hang around longer than they need to if they can't top up their pension, and could in turn lead to a 'grey brain drain'.

But need their departure leave such a gap in leadership skills? Lucy McGee, marketing director of HR consultancy DDI, points out that the legislation should merely accelerate what good companies are already doing. 'They probably need to get better at identifying and fast-tracking more people earlier so they can be ready for top

ILLUSTRATION: HENNING LOHLEIN



jobs sooner and at lower risk,' she says.

Kevin Wesbroom, senior consultant at Hewitt Bacon & Woodrow, puts it more forcefully: 'If HR doesn't start thinking more about talent management they may find half their board could be out the door and without suitable replacements coming up through the ranks.' That's a message that engineering consultancy conglomerate WS Atkins has taken to heart. Brian Fitzgerald, director of HR development, explains that over the past two years the company has 'cranked up' its management skills development as it attempts to meet its strategic objectives, as far as possible, with homegrown talent.

'We are looking very hard at how we identify talent and how we close the gap between what we have and what we want in order to move people more quickly from the "ready later" to "ready now" category,' explains Fitzgerald. The company has also taken a 'management development centre' approach to assessing, developing and motivating its managers to the benefit of both the business's and the individual's objectives. 'We take a holistic approach, which allows us to identify their particular strengths and areas for development, and to put them in a role where they can make the best contribution,' says Fitzgerald. 'That motivates them, maximises their value to us and fits in with our succession planning initiatives.'

And crucially, it has served as an important retention tool. 'Though you might expect senior managers to be the most susceptible to career advancement opportunities outside the company, attrition rates among this group are about 50% lower than in the rest of the business,' says Fitzgerald. 'The very fact that you tell someone you are going to be focusing on them has a big psychological effect.' He believes that creating a climate where senior man-▶

In with the new

agement knows that the company takes an interest in them makes them less vulnerable to external environmental influences like approaches from competitors or the pension cap.

Others share Fitzgerald's pragmatic view. For example, Mike New, director of reward at Centrica, says: 'We are not convinced there is going to be an exodus of people. If someone is going to retire they are likely to do it for more than pension reasons. And people now will have the option to retire and return to work, drawing their pension and salary for three years. So while their pension might be reduced, their income from working will more than compensate for it. I don't think the changes are going to precipitate a major shift in the psychological contract, though we are probably going to have to manage that more carefully.'

HR directors need to think creatively about restructuring pay and benefits

What the recent publicity over pensions does mean is that HRDs need to think creatively about restructuring pay and benefits – something that good companies should be looking at regularly in any case to maximise returns for both the employee and the business. While some form of cash bonus is likely to prove the most popular option, Paul Osgood, associate at Hewitt, Bacon & Woodrow, points out that compensation is only one element of executive engagement. 'There are big opportunities to renegotiate the employment contract in the broadest sense,' he says.

Eight key drivers play a role, continues Osgood: their relationship with colleagues and the board, the impact they make, their status, quality of life, the extra-curricular opportunities their job affords them – sitting on government committees, for example, their work, the values and reputation of the company, and compensation. Working out which combination of levers to pull for any given executive can secure the continued commitment and involvement of executives as role models, coaches and repositories of corporate memory even when they have left the company's full-time employ. Osgood believes the debate over pensions has accelerated the burgeoning of cadres of corporate alumni, as companies increasingly use their former executives in consultancy, interim and special project roles.

These people will also be available to other organisations, so serving to restock the interim, consultancy and, crucially, non-executive talent pool, points out Susannah Mitterer, head of consulting at people and organisational development consultancy TMI. 'Uncertainty over legislation has simply reinforced the twin trends towards a more flexible workforce and greater individual responsibility for people's personal development.'

The threat of a pensions cap has never been a major worry for Dick Etches, global HR director at GKN, although he admits: 'There may be more movement now in terms of people leaving because they have more choices about how and for how long they want to continue working, and that might lead to some pulling through in management succession. But that is far less of a concern to me than the proposed abolition of the retirement age in 2006, which will make it illegal to get rid of people at 65. What you do with the people you would actually prefer to leave is the biggest challenge on the pension and succession front, and requires a whole new dialogue.'

Lucy McGee, marketing director of DDI

Nevertheless, rather than simplifying pension provision as the Government intended, many companies are facing a difficult transitionary period. They will have to work out the likely impact on their business and employees and seek to put processes in place to mitigate the worst effects before legislation bites in April 2006.

Paul Charles, pensions strategy and policy manager at Diageo, says: ▶

The conflicting estimates at the heart of the pensions dispute

Putting a limit of £1.5 million on the tax-sheltered value of an individual's pension pot is part of the Government's attempt to simplify pension provision and encourage more saving. This was originally outlined in the consultation document, *Simplifying the Taxation of Pensions: Increasing Choice and Flexibility for All.* The Government stated that only 5,000 very senior and highly paid executives will be affected by the changes from the start (April 2006), with a further 1,000 being hit in every subsequent year. The National Audit Office estimate was roughly twice that produced by the Government.

Other estimates are massively higher. KPMG believes that senior and middle managers too are likely to be affected over time, estimating a figure of up to 600,000 over the next 15 years. Carl Sjostrom, a partner in KPMG's executive compensation division, suggests that even those earning as little as £50,000 today could be hit. And in a survey of the FTSE 500, carried out in December by Opinion Leader Research on behalf of KPMG, 81% of FTSE 100 companies admitted that the £1.5 million cap will affect senior managers, while 38% believe it will also hit middle managers.

Among FTSE 350 companies 88% of respondents believe senior management will be caught by the new rules, and 23% believe middle managers will be affected. The figures were similar throughout the FTSE 500.

The survey also revealed that 83% of respondents expect to have to overhaul their entire executive compensation structure. But although employers are likely to top up employees' pay with some form of cash bonus, more than half of the respondents anticipated that individuals would ultimately lose out. This is because employers would not be able to afford to compensate them fully for their lost (tax-advantageous) pensions benefits.

'Simplification as a principle is to be welcomed, but during the transitional phase [between now and April 2006] pension departments will be put under a lot of pressure. We will have to track individuals' benefits to see who is going to be affected, incur costs to provide financial advice for those who are affected, and communicate to all employees, past and present, as well as pensioners. During the coming three years we will need to put in a huge amount of effort – at an estimated cost to us of between £250,000 and £300,000 – merely to get from one tax regime to the next. If we have to overhaul our entire reward structure, that will incur even more costs.'

Brain Fitzgerald of WS Atkins

Even so, Osgood believes the fears are exaggerated. 'Sorting out the technical aspects of the changes isn't rocket science, and then it's a matter of finding something that motivates an executive as much as their pension,' he says, before going on to point out the positive benefits. 'The new rules allow employees to start drawing a pension while still working for the company, which could provide both employees who don't want to work so hard, along with companies who want to retain their knowledge, while motivating more junior executives, with a lot of very attractive flexibility. This is a great opportunity for a smart HR director to improve the transactional relationship between the company and its executives.'■

The view on pensions from HR

THE PESSIMIST
Paul Charles, pensions strategy and policy manager, Diageo

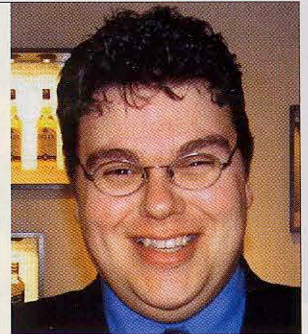
'We believe the new pension cap is a tax-raising exercise by the Government, aimed at the kind of highly-paid executives who are not going to get much sympathy if they complain. At Diageo at least 100 out of our 6,000 employees in the UK will be affected, and several hundred more will be caught over time. We are likely to offer compensation in the form of cash or an approved or unapproved scheme, but these people are effectively being forced out of the pension plan.

'The only way this company will get cost benefits out of this "simplification" process is if we reduce the generosity of our pension offer across the board.

'I think the net effect of the legislation will be to make pension benefits less generous and diminish the popularity of schemes even further – which is the opposite of what the Government wants to achieve.

'I am less concerned about people nearing retirement than I am about those currently in their 40s who, when the early retirement age goes up from 50 to 55 in 2006, face another 10 or 15 years working with no real incentive to be in an approved pension scheme. These are the people who, if they are severely affected, are most likely to up sticks and pick and choose among employers based on what they offer in addition to their pension.

'The change is also going to put remuneration committees, already in the



media spotlight over so-called "fat-cat pay", under renewed pressure, as they try to reconcile any requirement to compensate top earners with the interests of other stakeholders.

'We are seeing positive messages from the advisers, for whom the changes are going to prove a nice little earner. But we feel we are being forced to fix something – at considerable expense and effort – that isn't broken.'

THE OPTIMIST
Tim Miller, group head of HR, Standard Chartered Bank

'For most employees in most organisations, the new pension legislation represents greater flexibility when providing for retirement. You can contribute a much greater percentage of your earnings into a pension now which, given low contribution rates due to the poor general understanding of pensions, gives people the chance to catch up a bit.

'Around 20 of our 1,100 employees in the UK are likely to be affected but we expect many more staff to be hit within 15 years. In the light of that, we are looking at the whole reward mix, and are considering using bonuses, incentive and stock programmes in lieu of pension considerations.

'It has always been our policy to treat people as individuals and we try to tailor packages to suit their objectives and financial circumstances. But for the past year we have stepped up our conversations with each of our top 100 executives about the implications of the new legislation for them. We encourage them to talk to an independent financial adviser and are helping them work out individual financial and tax-planning programmes. We also look at the total value of the package and structure it in a way that gives them the greatest utility at the lowest cost for us.

'I don't think losing top people will be a problem for those companies that can demonstrate they are adding alternative value – and financial reward is not the sole motivator. We have one executive at the moment who wants a more plural lifestyle. We are

working on a plan to reduce her current full-time executive commitments, but which also allows us continuing access to her skills. The new legislation makes that much easier to do, as it offers greater flexibility over the amount of cash relative to pension employees can take.

'This is all part of the natural evolution to more flexible working patterns and ensures that both sides get the best value from the contract between company and employee.'