

## Building a Pile – Boardroom Pay at Taylor Wimpey plc

by Peter Parry, BA, MBA, Dip Inst M, MCIPS

In my *Examination of boardroom pay*, published by the UK Shareholders' Association in March 2015, I looked at the general concerns surrounding directors' pay. This paper looks at how those general concerns are reflected in specific issues at a particular company, the house builder Taylor Wimpey, where in 2014 Pete Redfern, the Chief Executive, earned a total of £5.8m – rather less than the £6.7m he earned in 2013 but still, as they say, nice work if you can get it.

Taylor Wimpey has not been selected for this study for any particular reason, as there is plenty of evidence to show that it is no different from many other FTSE100 companies in terms of the way in which its directors are rewarded. In fact, in many respects its remuneration report is a good example of clarity and completeness of information - for example, in relation to performance targets. Where clarity is lacking (for example, on how the pay levels shown in the performance criteria pay chart relate to the CEO's actual pay), there is no attempt to obfuscate, hide or deceive.

This paper seeks to answer a number of questions including:

- How easy is it for shareholders to monitor directors' pay in order to ensure effective governance over levels of remuneration?
- How good are the target-setting mechanisms which trigger bonus payments?
- How active are shareholders in trying to control directors' pay?

### **£12.5m over two years.....But is he worth it and is it necessary?**

Few would deny that Taylor Wimpey has done well in recent years. As the table below shows:

**Table 1. Taylor Wimpey Performance 2008 - 2014**

	2014	2013	2012	2011	2010	2009	2008
Profit (loss before tax and exceptional items)	£450.1m	£268.4m	£181.8m	£89.9m	(£15.9m)	(£96.1m)	(£74.7m)
Adjusted earnings / (loss) per share	11.2p	6.7p	4.6p	2.1p	(1.5p)	(4.3p)	(7.2p)
Return on capital employed	20.6%	14.6%	11.3%	8.3%	4.9%	1.5%	2.6%

Progress since 2008 – the point at which the housing industry in the UK hit the buffers as the financial crash took its toll – has been impressive. However, as always, the starting point when measuring performance is important. It is worth noting, therefore, that in 2007 profit before tax and exceptional items was £346m, earnings per share (EPS) were 29.5p and the return on capital employed was 14.8%. In other words, much of the good work over the last seven years represents progress in repairing the damage caused when the house-building industry suddenly slowed down in 2008 and Taylor Wimpey was left trying to manage a debt-pile of £1.9bn.

Pete Redfern was appointed CEO of Taylor Wimpey in July 2007 following the merger of George Wimpey plc and Taylor Woodrow plc. He was not a newcomer on the scene even then having been Group Chief Executive of George Wimpey plc prior to the merger and, before that, successively Chief Executive and Finance Director of George Wimpey’s housing business. While nobody would suggest that the dire situation in which the Company found itself in 2008 was brought about deliberately, the directors in post prior to 2008 must be considered at least partly responsible for allowing it to happen.

While the Company may have made sound progress over recent years, long term shareholders have had a torrid time since 2007. Taylor Wimpey’s share price fell from a high of 397p in April 2007 to just 7.5p on 18<sup>th</sup> November 2008. In May of that year the Company had failed to get a £500m rights issue off the ground and was in serious danger of breaking its banking covenants. In 2009 it finally managed to complete a comprehensive refinancing which included a £520m rights issue with shares offered at 25p. Comment at the time suggested that the only reason Taylor Wimpey survived was because the banks in their own straitened circumstances hadn’t the stomach to put it into receivership. With the shares now trading at 176p (8.7.2015) and dividends restored investors who managed to hang on during the white-knuckle ride of the last eight years are starting to see light at the end of the tunnel. Those brave enough to buy in at around 10p in 2008 are sitting on large gains, but those who owned shares at the time of the merger continue to nurse large losses.

So Pete Redfern is being handsomely rewarded for rescuing the Company from a near-death-experience that he in part, however inadvertently, helped to cause. Before going on to look at his remuneration package, remember that the house-building industry has enjoyed fair winds since 2009. Persistent talk of a housing crisis has led the government to encourage banks to lend to home buyers, while schemes such as Help to Buy have added further impetus. The increase in house-building may not have been stunning but the environment has certainly been conducive to recovery and what some might see as easy profitability.

### **£12.5m over two years.....How did he end up getting so much?**

The Annual report for 2014 shows that Pete Redfern’s remuneration over the last two years comprised the following elements:

**Table 2. Composition of Taylor Wimpey CEO’s pay 2013-2014**

<b>Component</b>	<b>2013 £’000</b>	<b>2014 £’000</b>
Fees and salary	£749	£768
Benefits	£30	£43
Short term incentive award	£1,018	£1,043
Long term incentive plan	£4,747	£3,770
Pension	£180	£185
<b>TOTAL</b>	<b>£6,724</b>	<b>£5,809</b>

It is interesting to note that ‘fees and salary’ (basic salary) makes up just 12 – 15% of total pay while around 60% of the whole package in each year is accounted for by long term incentives (LTIPs). As with so many other FTSE companies, these LTIP awards typically take the form of share options and ‘performance shares’.

In many respects Taylor Wimpey's Remuneration Report is good, in that it gives plenty of detail about directors' pay and its composition. It also gives plenty of information about the performance criteria that directors have to meet to achieve their bonus targets. One may disapprove of the levels of pay but the remuneration report scores well on information disclosure. But just how helpful is some of this information for shareholders who are supposed to control directors' pay by monitoring and voting on proposed pay awards?

The 2014 Annual Report gives a Performance Criteria Pay Chart showing the pay that Pete Redfern and two other directors can earn over the coming year (ie this year, 2015) depending on their performance. For Pete Redfern the Pay Chart shows the following information:

#### Performance Criteria Pay Chart 2015

	Below target	Target	Maximum
% of remuneration accounted for by:			
• LTIP		16%	42%
• Bonus		31%	31%
• Salary	100%	53%	27%
<b>Total Remuneration £'000</b>	<b>£1,030</b>	<b>£1,946</b>	<b>£3,816</b>

From this shareholders might think that the maximum amount that Pete Redfern can earn in 2015 is £3.8m. This is significantly less than the £5.8m that he earned in 2014. So does this mean that the board is starting to get the CEO's pay under control? The answer to this is, no! If we look at the Performance Criteria Pay Chart in the previous year's (ie 2013) Annual Report we can see that this is far from being the case.

#### Performance Criteria Pay Chart 2014

	Below target	Target	Maximum
% of remuneration accounted for by:			
• LTIP		16%	42%
• Bonus		31%	31%
• Salary	100%	53%	27%
<b>Total Remuneration £'000</b>	<b>£962</b>	<b>£1,829</b>	<b>£3,601</b>

This suggested that Pete Redfern might earn a maximum of £3.6m in 2014. In fact, we know that he earned £5.8m. If we look back to the 2012 Annual report a similar picture emerges. The Performance Criteria Pay Chart suggests that Pete Redfern might reasonably have expected to earn about £1.7m for 'Target' performance and that the maximum he could possibly have earned given spectacular performance would be £3.5m. But, as we know, he was paid £6.7m in 2013 - almost double what we might have expected from the information given in the 2012 Annual Report.

So has Pete Redfern's remuneration always been significantly higher than shareholders might have expected? The 2012 Annual report shows his total pay took a sudden leap in 2013 as the table below shows.

**Table 3. Taylor Wimpey CEO Total Remuneration 2011 -2014**

	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Total remuneration £m	£5.809	£6.724	£1.837	£1.771

Thus, it was only from 2013 that fairly aggressive share option and ‘performance share plans’ put in place in 2008 (and approved by the shareholders at the time) started paying out. Superficially, the logic of this sounds simple, but let’s just take a closer look at how it all works.

In March 2015, I wrote to Taylor Wimpey and the Company Secretary promptly responded with the following fulsome explanation:

*The pay scenario chart, looking forward to the year in question, and the pay table published the following year, looking back at the year in question, have different constituents.*

*The former shows what an Executive Director’s LTIP reward would be, if maximum vesting was achieved, when that LTIP vests. That is three years’ hence, at the end of the LTIP performance period, and not the following year.*

*The following year, we report pay, benefits, pension and STIA (bonus) all as per the pay scenario chart forecast published the preceding year, but the one remaining element of that year’s cash receipts – LTIP vesting – relates to an LTIP awarded three years earlier, whose three year performance period has just ended.*

*Thus there is a disconnect between the elements in the 2014 pay scenarios as forecast in the 2013 Annual Report, and the element included in the reporting of the cash actually received from the Company during 2014 as reported in the 2014 Annual Report. The LTIP in the former (the pay scenarios chart for 2014 in the 2013 Annual Report) is the 2014 LTIP award that may vest in 2017 and be reported in the cash earnings for 2017; whilst the LTIP in the latter (the pay table for 2014 in the 2014 Annual Report) includes the value of the LTIP awards from 2011 (part) and 2012 (part) that vested during 2014, as described on page 79.*

*During the three year performance period of the awards made in 2010 and 2011 but vesting and paid out in 2014, the shares awarded increased in value on the Stock Exchange by 192% (2011 LTIP award shares) and 161% (2012 award).*

*In reporting terms, the methodology to be used for each of the scenario chart for a year and the single figure reported for the same year, are prescribed by statute, and thus give rise to the apparent inconsistency you have identified.*

Did you understand all that? No....? Well, I’m not sure that I do either. I sort of get the gist of it but the complexity of the whole arrangement means that it is nigh on impossible to understand what Pete Redfern’s total remuneration is going to be in any given year – even if we assume for the sake of simplicity that he will achieve or exceed his most stretching performance targets for the coming year. I suspect that even he may not fully understand it.

One other point to note is the comment by the company secretary that Taylor Wimpey is following a reporting methodology which is prescribed by statute. In other words, if the information is presented in a way that is misleading (and which also strikes at the heart of effective governance), it is not the Company's fault. This is a matter of concern to the UK Shareholders' Association, which was taken up unsuccessfully with the previous Secretary of State for Business (Vince Cable) and is likely to be raised again with his successor (Sajid Javid).

### **£12.8 million over two years....So what performance targets were set?**

Once again, the Taylor Wimpey remuneration report provides plenty of information on the performance targets that were set and the performance that was actually achieved in respect of 2014. The table below shows for the short term incentive award (SITA):

- Each of the performance metrics;
- Each measure's weight as a proportion of the total short term incentive plan;
- The three targets for each metric (Entry, Target and Stretch);
- The actual result achieved;
- The percentage of bonus achieved against each target.

**Table 4. Short Term Incentive Targets 2014**

Measure	Weighting	Targets	Result	% of maximum
Profit before tax (PBT)	40%	Entry £380m Target £400m Stretch £420m	£481m	40%
Return on capital employed (ROCE)	10%	Entry 14% Target 15% Stretch 17%	19.8%	10%
Operating margin	10%	Entry 15% Target 16% Stretch 17.5%	17.9%	10%
Net cash / (Debt)	25%	Entry (50)m Target £0m Stretch 100m	£162.5	25%
Customer Service	10%	Entry 89% Target 90% Stretch 91%	83%	0%
Energy reduction	5%	Entry 80% Target 85% Stretch 90%	95.4%	5%

Let us ignore the fact that it is not clear how performance against some measures has been assessed (particularly customer service and energy reduction). The specific points that immediately stand out from this table are these.

- All the so-called 'stretch' targets, except for customer service, have been easily beaten. This is particularly true for PBT and net cash.
- These are not just the 'on budget' targets; these are the 'stretch' targets – the ones that you might think would be difficult to achieve.
- These are targets for the *short* term incentive plan. As they are short-term targets it should not be so very difficult for those setting the targets to take a reasonable stab at what might be realistic – although that seems to be far from what has happened in this case.

- It is telling that the one target which has been missed by a mile is customer service – one of only two non-financial measures and one which should surely be of great strategic importance and therefore affecting long term performance. Yet it gets a weighting of only 10%, as a *short term* measure.

Turning to the previous year, 2013, again looking at short term measures, all the ‘stretch’ targets were comfortably beaten except for energy reduction and customer service. The latter got only a miserable 5% weighting in 2013. Interestingly, the actual achievement for customer service in 2013 was 88% - better than the 83% achieved in 2014. The vital question for shareholders, however, is: if so many of the ‘stretch’ targets were comfortably beaten in 2013 why were they not tightened to make them more realistic and stretching in 2014? If anything, the ‘stretch’ targets seem to have been beaten even more comprehensively in 2014.

Let us look briefly at vesting of Long Term Incentive Awards in 2014. These are important, because if the ‘stretch’ targets are achieved they can account for 40% of the total pay award (but only 10% if just the ‘target’ performance is achieved).

**Table 5. Long Term Incentive Targets 2014**

Measure	Weighting	Vesting scale	Performance achieved	% of this award vesting
TSR versus FTSE	20%	No vesting below median, 20% vests at median, 100% vests at upper quartile. Pro-rata vesting between median and upper quartile.	7 <sup>th</sup> out of 203	100%
TSR Peer Group	20%	No vesting below median, 20% vests at median, 100% vests at upper quartile. Pro-rata vesting between median and upper quartile.	4 <sup>th</sup> out of 13	93.8%
ROCE	30%	No vesting below median, 20% vests at median, 100% vests at upper quartile. Pro-rata vesting between median and upper quartile.	22.5%	100%
Margin	30%	No vesting below median, 20% vests at median, 100% vests at upper quartile. Pro-rata vesting between median and upper quartile.	17.9%	100%

Once again, these measures of performance prompt a number of doubts and questions.

- Why is it appropriate for any to be based on relative performance?
- Precisely what is the basis on which relative performance for ROCE and margin is to be calculated?
- How is the weight given to TSR as measure for assessing relative performance justified? It is one of a number of potentially useful measures but it is open to manipulation and it is very questionable whether it justifies 40% of the LTIP award.
- How relevant is it to measure TSR against the FTSE? Why not measure it against a peer group of house builders on a more relevant basis, instead of the FTSE comparison?

- Double-counting by using the same or similar measure of performance twice. Setting aside the fact that the method of assessing margin and ROCE seems to be different from that used in the Short Term Incentive Award (STIA), is it really appropriate to be measuring the same things but in different ways for both the short term and long term awards?

Taylor Wimpey does deserve credit, however, for giving a reasonable amount of detail about the performance measures on which the CEO's short-term and long term-bonuses are based. Other companies are much less open. The Midlands-based engineer, Hill and Smith, simply states in its remuneration report:

*The Remuneration Committee is aware that some shareholders wish to see detailed retrospective disclosure of bonus targets, however the Committee considers this inappropriate given that such disclosure would provide information relating to the company's approach to annual budgeting.*

A remuneration committee prepared to fob the shareholders off with this sort of excuse should be treated with the contempt it deserves.

### **£12.8 million over two years....It's hard to see the justification. So who would support it?**

I put this question to the Company Secretary at Taylor Wimpey by asking how many people voted in favour of the remuneration report at the AGM this year. Votes were received in respect of 60.9% of the shares issued. Of those for and against, 99.4% voted in favour of accepting the report of the Remuneration Committee. With regard to the issue of controlling directors' pay, this really says it all. Despite the concerns that the report of the Remuneration Committee raises about Pete Redfern's pay, less than 1% voted against it by proxy at the AGM.

### **Conclusions**

Taylor Wimpey is just one example of a FTSE100 company in which directors' pay appears to be excessive. It is easy to fulminate about this and to claim that this is tantamount to theft of shareholders' money on an heroic scale. In reality, however, the Company is not doing anything illegal. It is compliant with all the statutory requirements on directors' pay and it does not deliberately seek to hide information about the composition of directors' pay or how it relates to performance targets. Pete Redfern is well regarded as a CEO and most who know him accept that he worked tirelessly to turn the Company around following the disaster that ensued from the financial crash in 2008/9. However, my wife and I are the owners of a very handsome lurcher. He is an excellent dog but we have learnt the hard way not to leave food on the worktops where he can help himself.

For shareholders the issues that stand out from this analysis are:

- There is an abundance of information contained in remuneration reports these days. Some of it is very useful. Some of it (for example, the information contained in the Performance Criteria Pay Chart) is patently misleading – despite the fact that it complies with statutory requirements.
- The way in which performance is measured is, in many areas, seriously deficient. Targets are set that are too easy to achieve, the performance criteria adopted often include 'double counting' (the same criteria used for the long and short term awards), they focus on financial metrics that can be manipulated (for example EPS) while strategic targets such as customer service are often absent or receive a low weighting. There is often little to show that the CEO has had a major effect on business performance against these targets.
- Despite the obvious concerns that the report of the Remuneration Committee throws up at Taylor Wimpey, over 99% of the votes cast at the AGM were cast in favour of the report.

According to the annual report the largest share holders in Taylor Wimpey as at 2<sup>nd</sup> March 2015 were JP Morgan Asset Management, FMR LLC (Fidelity Management & Research), Schroder PLC, Legal & General Group PLC and Standard Life Investments. These four held 20.7% of the shares. The top ten shareholders listed in FT Markets.com in June 2015 accounted for over 36%. Organisations like these, and others, who manage other people's money (through pension schemes and other collective funds) which have consistently shown themselves to be poor stewards of that money. Faced with the complacent, laissez-faire and (one suspects) self-interested approach that the many City institutions adopt on directors' pay, it is hard to escape the conclusion that government sponsored action may be the only way to sort out the current piecemeal mess that that passes for a governance system in which shareholders are supposed to control directors' pay. In its absence the UK Shareholders' Association will strive to present the facts for others to judge.

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