News release

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Executives don't value their pay plans – PwC and LSE study

- Many aspects of current incentive plans don't motivate the executives they are aimed at
- Increased complexity and deferral puts upward pressure on pay levels
- Most executives are risk averse and would prefer lower, less volatile pay over a complicated, potentially higher reward
- Perceived fairness of pay relative to peers is more important to executives than what they are paid in absolute terms

London, 21 May 2012 - Incentives have become so complex and volatile that they no longer motivate the executives they are aimed at. This is according to new PwC research in conjunction with the London School of Economics and Political Science, which found that many features of current pay packages mean that the value executives place on them is materially lower than the cost to companies of providing them. In many cases executives would be happier being paid a smaller salary in a less complex and less volatile form.

The "Psychology of Incentives" study of over 1,100 participants reveals that executives are risk-averse, don't like complexity and discount deferred pay. According to the research, deferred bonuses hold little incentive, with the majority of executives valuing a £100 of bonus in a typical deferral plan at only half its value (£50). This discount is massively in excess of economic discount rates and the perceived value drops to as low as £33 for younger employees (those under the age of 39). Discounts also vary significantly in different regions of the world, showing that "one-size fits all" pay packages may be ineffective.

Tom Gosling, head of PwC's reward practice said:

> "These findings place a major question mark over the effectiveness of deferred bonuses, which have been championed by shareholders, regulators and corporate governance bodies as a powerful way of influencing behaviour while at the same time encouraging prudent risk-taking. It is difficult to see how a form of pay that has such low perceived value can have a significant influence on behaviour. A very real consequence is that as deferral increases, we would expect there to be pressure to increase pay levels."

Complex and uncertain incentives are also revealed as a massive turn-off for most people. The research reveals that two thirds more respondents (51% versus 27%) favoured a cash plan based on profit targets that they understand over a more ambiguous share plan based on their share price relative to other companies. The more complicated the reward, the more likely participants were to choose the smaller but more certain reward.

Tom Gosling, head of PwC's reward practice, said:

> "UK executive pay is based on the motivational theory that loading executives up with large amounts of incentive pay with complex performance conditions means that they'll perform better for shareholders. Unfortunately this isn't supported by our study, which shows that complex pay plans are a motivation killer. The more complex the pay, the lower the value in executives' eyes.
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> "We're paying company managers as though they are risk-seeking entrepreneurs. Our research shows that corporate executives are generally risk averse, and don't value long-term incentive plans and deferred bonuses.
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> "We need to simplify pay significantly. We've tried to put too much of the package into complex incentives that executives don't value, and this is leading to volatility of pay-outs and unintended consequences. If we had simpler, less volatile pay plans then most executives would be happy to be paid less."

The research also highlights that executives are very concerned about the perceived fairness of pay. For the majority (51%) of respondents, getting paid more than their peers was more important than getting paid more in absolute terms (27%). In many countries there is a drive for greater disclosure of pay on the basis that this will lead companies to exercise restraint. But PwC's research suggests the opposite, that disclosure will simply provide more opportunities for cross-comparisons and consequent pay ratcheting.

Tom Gosling, head of PwC's reward practice, said:

> "Executives are really focussed on the fairness of pay outcomes. Complex and volatile plans lead to windfalls that executives don't thank companies for, and periods of unfair underpayment that are highly demotivating. This creates a "lose-lose" situation for executives and shareholders. Simpler, more stable plans, with a greater role for remuneration committee discretion, are likely to be more effective at motivating executives and will also cost companies less."

Notes to editors

1. The Psychology of Incentives research was carried out by PwC in conjunction with the London School of Economics and Political Science. 1,106 participants took part in the study.

2. For a full copy of the report please contact Amy Tiernan on tel: +44 (0)207 804 0556 or email: amy.tiernan@uk.pwc.com

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