## REWARD STRATEGY FOR tie ltd 2007 ONWARDS

## CONTEXT

2006 has seen a significant transformation in **tie**. From essentially a project development organisation of projects and a delivery vehicle for the supporting parliamentary processes **tie** is now responsible for project managing and successfully delivering world class transport infrastructure projects valued in hundreds of millions as well as a portfolio of smaller business aligned projects.

The last three months in **tie** has seen a significant investment in a fit for purpose delivery organisation, a new leadership team, additional resources with enhanced delivery capabilities and a clear focus on successful delivery and performance.

**tie**, as a major project management delivery vehicle, is now competing against the very best in the private sector for scarce talent and resources in the rail, transport, engineering, construction and infrastructure markets. Experience already has demonstrated that the market is extremely tight with mediocre talent attracting significant premiums and exceptional talent being exceptionally rewarded by, and locked in to, their businesses through market leading salary, benefits and both long and short term incentive opportunities based on business performance and delivery. (Appendix 1, A review of Resourcing Challenges for **tie** is attached for information)

Furthermore **tie** does not yet have the brand, maturity, future pipeline or resources to compete as an effective employer of choice in the open market.

What **tie** has is:

- a portfolio of projects and opportunities second to none in Scotland
- an organisation that is growing and exciting and focused on success
- potential future opportunities
- an ability to be flexible and resourceful.

**RESPONSE**

The critical need for **tie** in the coming months is to successfully attract resource and deploy high performing and at times exceptional talent in leadership and delivery roles and to maximise the HR interventions that enable the attraction and retention of such individuals. High performing leadership teams are measured essentially by successful delivery of their business. **tie's** business is to successfully deliver infrastructure projects to time, to cost and to budget and ensuring stakeholder satisfaction with the end product. These are critical investments for the political, economic and social infrastructure of Edinburgh and Scotland and as such deserve to have the best and appropriate resources deployed to deliver them to or beyond expectation.

There is some evidence that **tie** can already barely compete on total package value with salaries having to incorporate benefit equivalents. (e.g. car allowance, private health, fuel and other benefits common within the market) The offer of a final salary pension scheme or a contribution to personal pensions is an added attraction.

Furthermore at critical director and senior manager level the majority of competitors are offering highly geared annual bonus opportunities and share driven long term incentive plans over three to four year windows.

**tie** is entering a critical six to nine month resourcing and deployment phase where the attraction and retention of critical senior and delivery staff is vital to both the successful delivery of the projects and creating a sustainable delivery organisation. It cannot afford to be disadvantaged in the market for talent nor how it motivates and rewards performance, delivery and success. Key part of this is incentivising successful delivery for key senior executives and employees mixing both short term and long term opportunities.

The reality is that **tie** is competing in an ever tightening market and **tie** has less flexibility, benefits or additional resources to deploy when the talent war ensues across the next four years. This will worsen when the South East heats up for the Olympics which will suck resources directly or indirectly all across the UK and beyond.

In the Scottish market **tie** will be competing against other major infrastructure projects such as GARL, Airdrie-Bathgate, M74 extension, utility renewal contracts and the continuing roll out of major PFI programmes in education.

Currently **tie** has three levels of annual performance bonus for its employees from 5% to 10% to 15% depending on grade of employee. Whilst there is an adequate performance management process in place it is necessary to standardise, align and enhance the process of new incentive arrangements to support successful delivery of the business to drive success for all stakeholders.

Annual performance bonus opportunities for directors and senior managers in project and construction organisations are typically in a range from 30-100% of salary with median around 50% and typical payouts in range of 60-80% of opportunity. The majority of these organisations are providing annual incentive opportunities for all employees that further support, drive and reward organisational and project success and delivery.

Long Term Incentive schemes, based primarily around share allocation and share lock-ins, and measured over 3-4 year time frames are highly common and effective for executive directors in the private sector and particularly in delivery and project businesses. This is a critical intervention to be deployed by **tie** to support senior attraction and retention. The solution need needs further exploration and investigation to assess the consequences and the design of a “phantom scheme” based on cash equivalents. This matter does open up a number of legal, accounting, political, tax and governance issues that would require clear guidance and agreement.

To address this resourcing and reward reality the recommendations are that:

- **tie** significantly redesigns the current annual incentive arrangements for the business and reflects more accurately the incentive opportunities that exist for senior executives (7 roles) in the market with full introduction for 2007/8.
- it is proposed that LTI arrangements for **tie** directors and selected key senior staff are fully explored and reported to the RemCom by end of 2006
- **tie** provides all direct employees (c48 employees) have a significantly improved opportunity to share in the successes of tie with new bonus arrangements introduced in 2007/8
- a robust and relevant senior management salary benchmarking exercise is undertaken in early 2007
- all this is underpinned by an enhanced performance management process introduced for 2007/8.

## RECOMMENDATIONS

### 1. Annual Performance Bonus Executive Directors

For all **tie** executive directors on management board reporting directly to Executive Chairman, and recommended other senior managers, to have an annual bonus opportunity of 50% of salary. (Currently 7 roles) This to take effect from 1st April for existing appointments. Any new appointments to take effect from start of employment. Performance measure aligned to financial year.

The elements to be:

- **Financial and Business Performance** - objectives based on Annual Budgets, business operational objectives and strategic imperatives in range of 70-80%
- **Personal Performance** – personal and professional objectives monitored against performance reviews and 360 degree reviews to maximum of 20-30%
- **Safety Performance** – gateway based on safety performance against set KPI's and impacting in range of +/- 20%

The total of the first two elements would be no more than100% with safety performance impacting on the total.

### 2. Long Term Incentives

Central to the ability of **tie** to attract and retain critical high performing directors and senior management is the ability to mutually "lock in" business and project delivery critical talent. The mechanics of establishing a phantom LTI cash equivalent schemed aligned to longer term strategic performance benchmarked against external measures and competitors to be fully explored and reported to Remuneration Committee December 2006. Intention being to launch with 2007/8 financial year.

### 3. Annual Performance Bonus Employees

For all direct employees to have an annual performance bonus opportunity of 25% of salary. All good practice and successful schemes have a common opportunity for all employees, is inclusive and recognises contribution and opportunity equally. To take effect from 1st April.

The elements to be:

- **Business Performance** - objectives as above in range 40-80% depending whether project or central services based employee
- **Project Performance –** objectives based on Annual Budgets, project operational objectives and milestones for project based employees in range 0-50%
- **Personal Performance** – personal and professional objectives monitored against performance reviews and 360 degree reviews to maximum of 20-30%
- **Safety Performance** – gateway based on safety performance against set KPI's and impacting in range of +/- 20%

The total of the first three elements would be no more than100% with safety performance impacting on the total.

**4. Salary Benchmarking Exercise**

To commission external benchmarking exercise early 2007 to determine and validate appropriate management salary and total reward benchmarks to support effective attraction and retention interventions through 2007 and onwards. Current grades set from benchmarks and data provided by KWB in February 2005.

**5. Enhanced Performance Management Process**

To introduce with the above changes new performance management process for all employees based on minimum bi-annual reviews with core and common business and project aligned deliverables and objectives. Primary focus on delivering successful projects through high performance and ensuring operational competencies. Aim to establish a high performing, self auditing and self calibrating project organisation. (Model pro-forma attached Appendix 2.)

**6. Impact**

Clear, critical, measurable and shared goals and objectives are central to enhancing performance and delivery. The **tie** business and project goals are clearly determined through strategic and operational business planning processes and documents. Setting stretch targets would be fundamental to achieving high end bonus payments with on target performance around 60-70% of opportunity. Indeed research shows that on successful schemes pay on average in a range between 60% and 80%. Tie historically has paid around 80% plus. Costing and funding are vital elements and based on September 2006 salaries the costings are as follows:

| **Base** | Current Salaries (Sept 06) Max 100% Opportunity (15%, 10%, 5%) | Current Salaries (Sept 06) 80% Payment (15%, 10%, 5%) | Current Salaries (Sept 06) 100% Opportunity (50% and 25%) | Current Salaries (Sept 06) 70% Payment (50% and 25%) |
|---|---|---|---|---|
| **Cost** | **£195,000** | **£155,000** | **£540,000** | **£375,000** |
| **Average** | £3,900 | £3,100 | £10,500 | £7,400 |

These are pure salary costs and don't include any employer National Insurance or tax liabilities but are outside pension contributions of 18.8% and are more cost effective and variable than direct salary. The delivery would be funded by exceeding budgets, plans, expectations and targets. An accrual would have to be built in to budget to cover liability. Furthermore improved employee performance and delivery would reduce the need for and cost of 3rd party or contract support. With an average salary of £39,000 a variable element of pay of a further 25% is a significant incentive.

Need to ensure that both key stakeholders and all participants support and appreciate the requirements and implications of such interventions and that these are essentially to drive and reward improved performance and delivery of the projects to these same key stakeholders.

Critically these measures would significantly improve the ability of tie to attract and retain high performing and delivery critical resources at all levels. For Directors long and short term incentives both lock and reward performance and delivery into the business and reflect the realities of the market place that tie is operating in if it wants to deliver projects that are valued in the hundreds of millions.

**Assurance**

It is recommended that all performance measures and parameters for both Annual and Long Term schemes for executive directors and key senior managers are presented to the Remuneration Committee to validate and to provide support in the evaluation assessment process. In addition it is commended that external validation through appropriate 3rd parties is provided on an ongoing basis to address market comparability and performance measures and comply with any corporate governance issues.