

BBC EXECUTIVE REMUNERATION REVIEW

The BBC Trust has agreed with the Director-General, Mark Thompson, to a significant reduction in the cost of senior management across the BBC's public services. The outcome of the executive remuneration review, initiated by the Trust and undertaken by the Director-General, will be a revised approach to managing senior remuneration at the BBC and a clearer focus on the BBC's approach to pay as a publicly funded institution.

As part of this review, the Trust has agreed that the total spend on senior management pay across the BBC should reduce by twenty-five per cent over the next three-and-a-half years. The Trust has also agreed to freezing the pay of the BBC's Executive Directors, including the Director-General, for a further three years.

The Trust acknowledges public sensitivities over the issue of senior manager salaries at the BBC, particularly in view of changed economic circumstances.

The outcome of the review achieves an appropriate balance between the need for the BBC to continue to attract talented staff to lead the organisation and deliver outstanding public service broadcasting, and Licence Fee payers' expectations that the BBC will offer value for money.

We welcome the Director-General's strong leadership in addressing this important issue.

BBC Trust

29 October 2009

BBC EXECUTIVE REMUNERATION REVIEW

Context

1. The BBC Trust is the governing body of the corporation – it aims to get the best out of the BBC for licence fee payers.
2. The BBC Charter specifies that the Trust's role is to establish the strategy for executive remuneration and to set the Director-General's salary; other aspects of senior remuneration fall to the Executive Board's Remuneration Committee, and day-to-day management of the BBC is the responsibility of the Director-General and his team. This review was undertaken by the Director-General and agreed by the Executive Board. The Trust endorses the conclusions contained within it.

Background to the review

3. The executive remuneration review was initiated by the BBC Trust in February 2009. At that time the Trust concluded that the strategy and policy agreed by the Trust the previous May needed to be reviewed. The Trust asked the Director-General and the Executive Board's Remuneration Committee to review both base pay and bonus payments. In establishing the review, the Trust stated its preference that bonuses for Executive Board directors be removed.
4. In July the Trust and the Executive Board's Remuneration Committee came to an agreement that bonuses for Executive Board directors would be suspended indefinitely. This was implemented immediately.
5. Through the review process the Trust came to the conclusion that it would like to see:
 - o a commitment to continued wage restraint at senior levels, expressed through an extension of the current pay freeze and suspension of bonuses;
 - o an expectation that, taken as a whole, future levels of pay for some key senior posts will be lower than now; and
 - o a target, or a series of targets, to reduce significantly the total amount spent on top salaries.

The BBC – a public service organisation

6. The Trust's approach to senior remuneration at the BBC is that it must balance the need to attract high calibre people to manage the BBC with the need to ensure value for money for Licence Fee payers.
7. The BBC is a public institution, paid for by the licence fee and accountable to the public through the BBC Trust. We believe that the remuneration policy must reflect the values of a public service organisation.
8. At the same time, parts of the BBC operate in commercial markets. The very best people that could work for the BBC may also be able to attract significant salaries in other organisations. The Trust believes that the benefits of working for the BBC are not just reflected in salary and therefore the BBC should be able to continue to attract high quality candidates at a significant discount to the commercial sector.
9. The Trust agrees with the conclusions of the review that the challenge is to "ensure that our remuneration practices do not undermine the trust and confidence of the very public that we seek to serve".

Conclusions of the review

10. The Trust endorses the conclusions of the review, which represent a significant change to the approach to senior remuneration at the BBC. There are long- and short-term actions that will be taken as a result. These are:
11. **Overall reduction in senior manager salary costs.** The Director-General has responded to the challenge set by the Trust and has agreed reduce the paybill as at 31 July 2013 for Executive Directors and Senior Managers by twenty-five per cent compared to the paybill for the same group as at 1 August 2009. This will be achieved through reducing costs as well as a reduction in posts.
12. **Base Pay.** To address concerns about the level of base pay to BBC senior executives a number of actions have been proposed by the Director-General and endorsed by the Trust. These will be implemented immediately:
 - i. The salaries of all members of the BBC's Executive Board as well as the BBC's Direction Group (the senior body under the Executive

Board) will be frozen for a further three years. There will be no salary increases for these staff until August 2013 at the earliest.

- ii. All 'senior manager' staff will have their base pay frozen for a further year. There will be no salary increases for staff at this level until August 2011.

13. **Bonuses.** Earlier this year the Trust agreed to an indefinite suspension of bonuses for Executive Board members. Bonuses for all staff were also suspended for the current year.
14. As a result of this review the indefinite suspension of bonuses for Executive Board members has been confirmed and extended to members of the BBC Direction Group. In addition, bonuses for all 'senior manager' staff will be suspended for a further two years.
15. **A new strategy.** The Trust also endorses the longer-term conclusions of the review, which set out a new strategy for senior manager remuneration at the BBC. These are outlined in detail in the report.

Implementation of these proposals will fall to the Director-General, but the Trust will keep under review in its regular meetings with him to ensure that the BBC continues to be able to deliver the high quality services that Licence Fee payers rightly expect.

A full copy of the report from the BBC Executive is attached.

We are also publishing correspondence between the BBC Trust and the Director-General regarding the establishment of the review.



BBC EXECUTIVE REMUNERATION REVIEW

I. Background

In February 2009, Sir Michael Lyons wrote to Mark Thompson and Marcus Agius to invite the Executive Board Remuneration Committee ('EBRC') to consider a number of questions related to the setting of executive base pay and to the future of executive bonuses, in the light of the changes to the wider economic climate and to the BBC's own financial challenges.

The scope of this review has been extended to include the remuneration of all senior managers (SM1 and SM2 grades). Although the Trust Remuneration & Appointments Committee ('RAC') remit covers only Executive Board members' remuneration, the Trust agreed to the scope-extension in order that a consistency of approach might be ensured, noting that the Trust do not have a role in remuneration strategy other than for executive board members. Whilst the Trustees initially proposed that the review be completed in time for publication within the ARA, they subsequently agreed that the timeline should be extended to the autumn, to allow for more careful analysis and discussion.

2. Context: evolution and impact of executive remuneration strategy

2.1 Evolution of executive remuneration strategy

Since the 1990s the BBC's executive remuneration strategy has evolved to reflect both the economic circumstances and the BBC's overall strategy, as well as the objectives of successive Directors General.

Under John Birt the BBC's strategic focus on 'excellence' was matched with a desire to increase business knowledge and expertise within the BBC, and managers were increasingly expected to have a strong understanding of financial practices and principles. As a result, the BBC recruited a number of individuals from professional services firms and other large corporate organisations, bringing in senior managers at remuneration levels which were closer to private sector benchmarks than had been the case historically. Although senior manager salaries were not published, over time the higher salaries paid to new recruits probably did create inflationary pressure on pay across the BBC.

In addition, the development of an independent sector and the greater commercial focus of both existing broadcasters like ITV and Channel 4 and of relatively new entrants like BSkyB and FIVE meant that the rewards available for senior creative leaders outside the BBC rose rapidly. In areas like television entertainment, commissioning and scheduling, movement of key staff between the BBC and other broadcasters increased and remuneration became an important factor in attracting and retaining senior creative talent.

The first professional external benchmarking of executive salaries was conducted in 1997 by Hay using the Hay's Boardroom Remuneration Guide, which included data on listed UK broadcasting companies and the Civil Service, and by 2000 this was extended to include telecommunications and technology companies. In 1999 the BBC also commenced participation in the Towers Perrin media sector survey as a source of additional data.

When Greg Dyke became Director General in 2000, a strong desire to create 'one BBC' led to common training and development programmes and, not unnaturally, a desire to achieve salary parity

across what had previously been a more disparate group. Increased BBC competition for talent in key output genres also led to higher salaries for senior managers, and to a renewed focus on variable pay to reward high performance, with the bonus scheme increased to provide a maximum payout of 30 per cent.

Since 2004, BBC executive remuneration strategy has sought to balance competitiveness with cost control, and balance public sector norms with commercial sector competitor practices. Key steps have been the reduction in the maximum bonus payable from 30 per cent to 10 per cent, and the goal of paying Executive Directors within an 80 - 120 per cent range of the median of their market rate for base pay, based on the Towers Perrin UK Top Executive General Industries Remuneration Survey, recognising that total remuneration would typically be far below private sector norms for senior staff.

2.2 Current competitiveness of BBC remuneration strategy and policy

The EBRC and BBC Trust RAC approved a revised executive remuneration strategy in May 2008, with the overall objective to “offer remuneration that attracts, motivates and retains the key talent required to lead the BBC and to deliver outstanding public service broadcasting”.

This strategy orients BBC executive remuneration principally towards the private sector labour markets from which the BBC generally recruits, rather than towards that of either the traditional public sector or so-called commercial public sector organisations (these are public sector or public funded organisations that directly compete with the private sector for talent such as the Royal Mail - this category is described in more detail in section 3 below). However, the strategy also recognises the necessary restrictions on the BBC’s ability to pay large cash bonuses and share-based awards.

The reward policy then sets out to implement this strategy by taking into account BBC-wide and individual performance, current economic and remuneration trends and market remuneration data, as described in section 2.1 above. A similar approach is adopted for determining SM pay, though with a greater degree of latitude driven by a wider set of considerations including peer group pay levels.

The EBRC believes that the policy in place has proven largely successful in delivering its overall strategy for executive remuneration: the BBC is typically able to recruit the calibre of leaders for which it is searching, and senior manager churn is considered to be healthy at around 11.5% average over the past 3 years and 9% in the last 12 months.

However, this review has identified a few areas where internal relativities and the desire to ensure that senior pay is broadly comparable in different parts of the organisation has led to pay rising above the median of the specific labour market involved. Similarly, it has identified a small number of ‘hotspots’ in which overall senior manager pay restraint has left BBC pay well below relevant labour market benchmarks. This is particularly true in the technology sector.

Notwithstanding these pockets, the general picture is one of restraint in pay settlements, with BBC senior managers receiving an average annual pay settlement that mirrors both the private and public sectors.

It is important to emphasise that this effect is seen across the staff population, not just senior managers. The 2008 suspension of bonuses for Executive Directors and all senior managers (made indefinite for Executive Directors in 2009) has meant that in many cases actual total cash remuneration has fallen. Moreover, the recent imposition of a pay freeze for SMs, and a centralised approval process for all pay increases and approval of all SM salaries on appointment, goes a significant way to addressing the issue of pay inflation.

2.3 Comparison of BBC bonus with public and private sector

The BBC's executive and senior manager remuneration policy features a variable bonus capped at a maximum of 10 per cent of salary, and for Executive Directors it is currently suspended indefinitely.

Performance-linked pay systems have become commonplace across the public sector since 1997, for example in the remuneration for civil servants, teachers, NHS consultants and senior police officers. The bonus pot for senior civil servants was set at 8.6% for 2008 and 2009, however the Permanent Secretaries agreed to forego their bonuses in 2009. Other public sector bodies have been under significant pressure to show bonus restraint in the current climate.

Private sector executive remuneration packages typically consist of three main components: base pay; variable pay (for example individual and corporate performance bonus); and long-term incentive plans (for example share options) with pension schemes being offered in addition. For on-target performance of a board level executive, these components might typically be of roughly equal size ie salary, bonus and share plans all contribute a third each to total remuneration.

The benefits of the BBC's current, essentially fixed, remuneration structure are that total remuneration can be predicted and controlled with high certainty. However, by comparison, a variable pay structure also brings some significant benefits:

- It provides a forcing mechanism for performance-management processes to encourage consistent behaviours and practices throughout the organisation
- It provides flexibility to recognise extraordinary individual contributions
- It aligns individual reward with success of the organisation
- It ensures that the total remuneration bill is flexible in response to market and financial conditions

2.4 Comparison of BBC pensions with public and private sector

The BBC, like many other organisations, has a mix of pension offerings determined from an individual perspective by the date of joining the organisation. New joiners to the BBC since November 2007 receive a career average pension scheme that accrues at 1/60 of salary, with a 4 per cent employee contribution, and this applies at all levels including executive board members. The BBC's two legacy schemes ('Old Benefits' pre 1996 and 'New Benefits' 1997- October 2007) are based on final salary, and accrue at 1/60 of final salary. The Old Benefits scheme features more generous early-payment terms and a number of other more generous provisions. The table below summarises the scale of the schemes, and highlights the difference in the BBC's contribution levels.

Table 1: Comparison of BBC pension schemes

Scheme	No. members (%)	No. SMs (%)	BBC Contribution %
Old Benefits	5,474 (31)	286 (46)	18.9
New Benefits	10,114 (57)	263 (42)	18.9
Career Average	2,113 (12)	74 (12)	18.9
TOTAL	17,701	623	N/A

For senior managers, their length of tenure also determines whether their earnings are subject to the £123.6 k annual earnings cap on pension payments. For executive board members with an earnings cap applying, a cash top-up of thirty per cent of incremental earnings is paid above the £123.6 k ceiling. The mix of schemes is shown below in Table 2.

Table 2: Executive board pension benefits

Section of scheme	Earnings cap applies	Exec Board members
Old Benefits	No	1
Old Benefits	Yes	1
New Benefits	Yes	5
Career Average	Yes	3

The significant variance in pension entitlements across the BBC is not currently taken into account by the benchmarking of base salaries under the current remuneration policy, despite the significant variance in the value of the packages, particularly for the most senior managers. However, we will explore ways of including an individuals pension provision as part of their total remuneration, and find ways of taking this into account in our benchmarking of total remuneration packages.

Within the public sector, most pension schemes remain linked to final salary, accruing at 1/60ths, and are therefore most similar to the BBC's more generous legacy schemes. In the private sector, final salary pensions are still the dominant form of pension provision for directors in FTSE 100 companies, with 56 percent of directors having Final Salary as part of their package. On average, the cost of the final salary earned in one year by an executive director is 70 percent of basic salary, which is far higher than at the BBC. This is because employers in the private sector will typically offer a significantly higher accrual rate for executive directors ie a top-hat scheme where the pension accrues at 30ths compared to the BBC's 60ths. However, two-thirds of final-salary plans in the FTSE-100 are closed to new members, and the majority of new-hires at executive level are offered defined contribution schemes, with employer contributions at 20 to 30 per cent of salary. The BBC pension provision for new executive directors is therefore less generous than that offered in the public sector and broadly comparable in relative value (though not in structure) to the private sector. Table 3 below shows a comparison of the BBC scheme for new hires with large public sector employers.

Table 3: Public sector pension comparison for new hires

Scheme	Type	Normal Pension age	Emp'ee conts	Emp'er conts	Rate of pension build up	Earnings cap	Other
BBC	Career Average	65	4%	18.9%	1.67% of salary	Earnings cap applied to basic pay	Revalued in line with inflation
Civil Service	Career Average	65	3.5%	Av. 19.4%	2.3%	No earnings cap for post 30 July 07 joiners	Revalued at RPI
NHS	Final salary	65	Tiered 5% to 8.5%	Capped at 14%	1/60 th	No earnings cap for post 1 April 2008 service	
GPs and Dentists	Career Average	65	As NHS	As NHS	1.87%	As NHS	Revalued at RPI plus 1.5%
Teachers	Final salary	60	6.4%	14.1%	1/60 th	Removed for post 1 April 2008 joiners	
Local Gov'tment	Final salary	65	Tiered 5.5% to 7.5%	Balance of cost	1/60 th	No earnings cap	
MPs	Final salary	65	10%	23.1%	1/40 th	MPs salary below earnings cap	Review underway

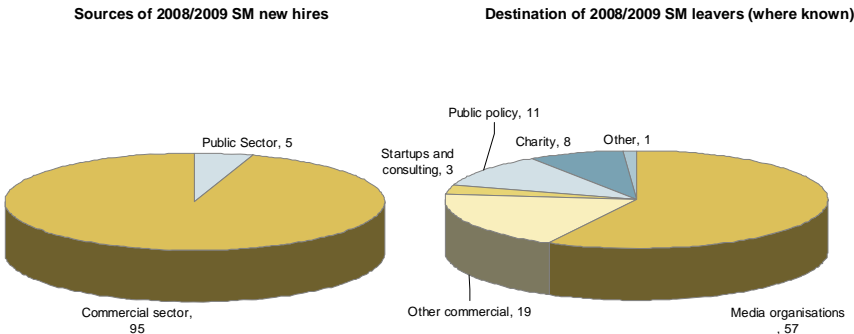
One significant factor is the comparison of whether an earnings cap (currently £123.6k) has been left in place in a scheme or removed, therefore making all earnings pensionable. At April 2006 the BBC chose to leave the earnings cap in place, mainly in order not to increase the level of liabilities in the

pension scheme. Table 3 demonstrates that most large public sector employers do not have an earnings cap in place or have removed it for new joiners, but most of these employers are not concerned with the liabilities in their pension scheme. The ONS pension survey for 2007 shows that approximately 60% of schemes have retained a notional earnings cap.

3. The market for BBC senior management

Unequivocally, the BBC competes with private sector organisations to attract and retain senior management talent. In the past 36 months, ninety-five percent of the sixty BBC Public Service external hires have been from private sector companies, whilst eighty percent of managers who left due to resignation went to the private sector. This is circa thirty managers over a 3 year period.

Chart 1: Source of SMs and destination of SM leavers



Whilst such a pattern might be expected for roles with few comparables across the public sector – for example television channel controllers or digital video technology experts – it also rings true for those functions such as legal, marketing and finance which are commonplace within the public sector, as well as within the private sector. The BBC, in common with many other public sector organisations, values the skills and experience brought by staff trained in the private sector, which in many cases (e.g. Marketing and HR) represents the great majority of the available pool of talent.

PwC benchmarked BBC pay at all levels against comparator groups within the private and public sector¹, and found that BBC pay and remuneration closely tracks the private sector for all levels except for SMs and Executives.

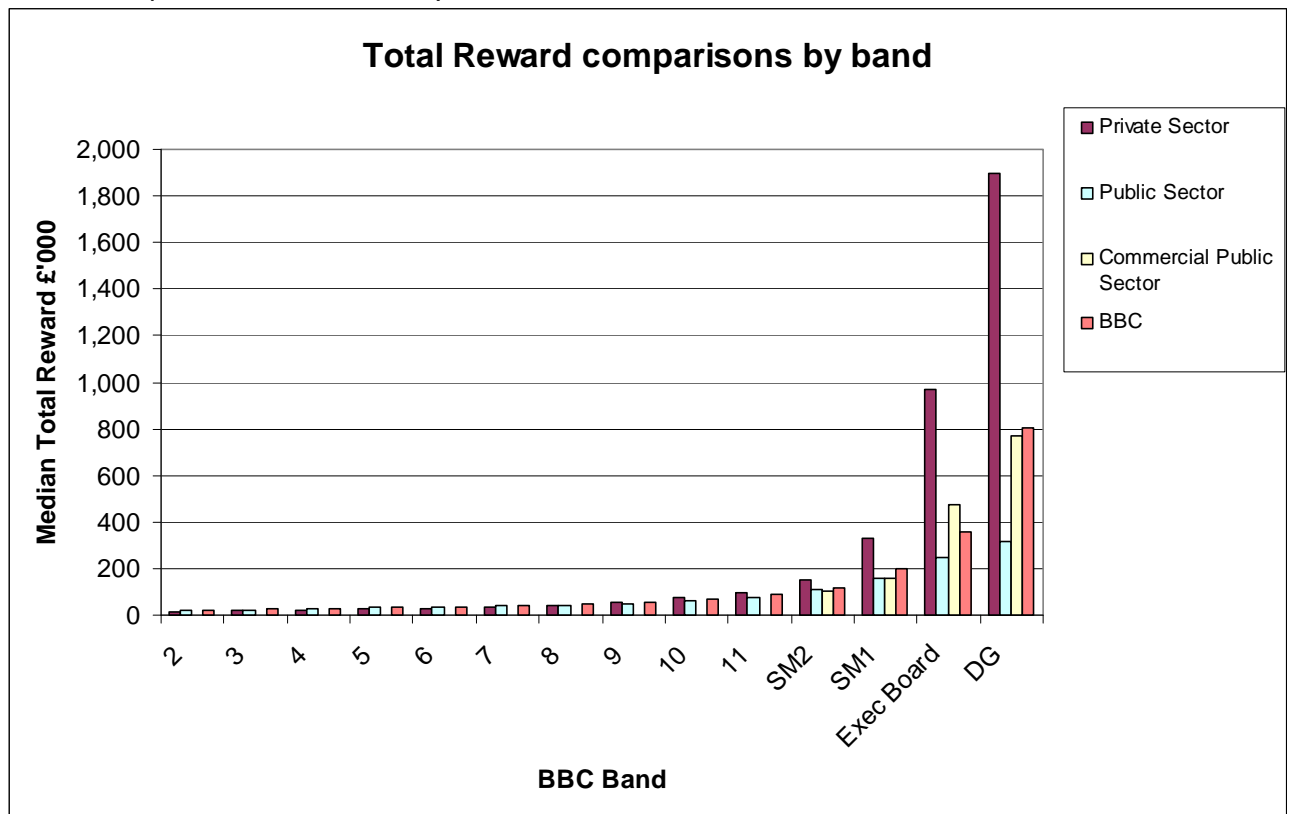
Looking only at salary, there is close parity with both private and public sector for all levels up to SM1, where higher pay levels in the private sector become more pronounced. Looking at the broader measure of total reward², we see that that the differential with the private sector becomes particularly significant at the SM2 level. It is also clear that although the current remuneration strategy states that Executive Directors should be paid within an 80 - 120 percent range of the

¹ The private sector comparisons below SMs are made based on the levels within the organisation, matching these to the typical BBC levels and an estimate of job size - in effect an assessment of the level of responsibility of the post based on the level within the organisation. At each level the samples typically include around 100 to 150 companies. Whilst many of these will be smaller organisations and the jobs will be different in content from those of the BBC they do provide a picture of how the BBC salaries compare with jobs of similar levels in the wider economy.

² This measure comprises basic salary, annual bonus, the expected value of long-term incentives, and benefits in kind.

median of their market rate for base pay, that in practice the majority are being paid within an 80 - 100 percent range.

Chart 2: Comparison of Total Reward by Band



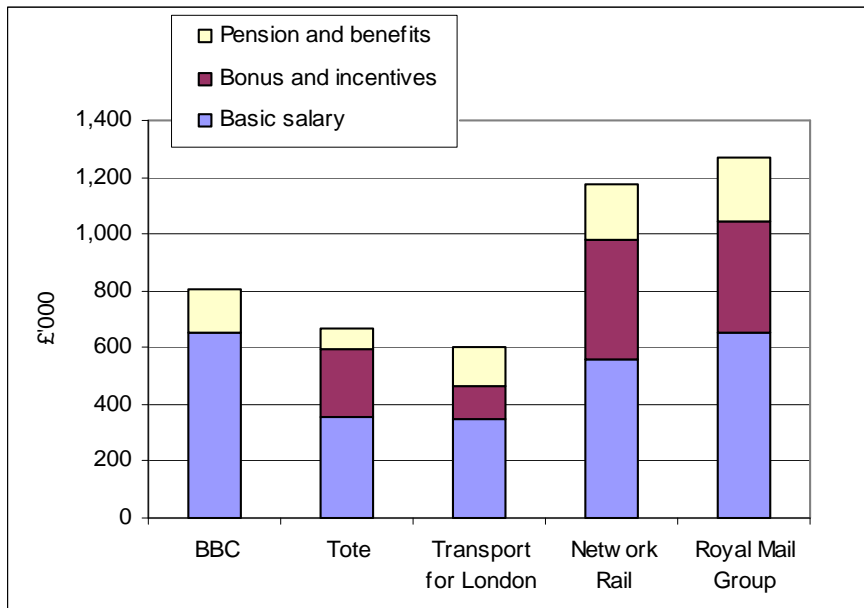
Source PwC

It is also interesting to consider the ratio of pay from the highest paid employee (the Director General) to the average paid employee: the ratio in the BBC is 1:17.5. It is important to use the average salary as the comparison point as the lowest salary does not typically vary between companies – all organisations tend to pay their lowest paid between £10-15k, whereas the salary for the highest paid person varies enormously thereby creating a very different ratio. In the Guardian Survey of Executive Salaries, published in September 2008 the ratios between the top paid executive and the average paid worker varied hugely from 1:550 (WPP) at the top to 1:7 (Alliance Trust) at the bottom. Other featured companies include Tesco- 1:526, Xstrata – 1:424, Sainsbury’s – 1:232, Reuters – 1:211, BAE – 1:164 Diageo – 1:143, Capita – 1:27, Severn Trent – 1:18 and BA – 1:15. The BBC ratio at 1:17.5 is very much towards the bottom end of the survey group.

Recognising that the BBC is by no means unique within the public sector in competing with private sector companies for its senior management talent, for the purposes of this review PwC identified a benchmark group of ‘commercial public sector’³ organisations, and analysed their remuneration practices at executive board level. Chart 2 above shows that the levels of total reward within this group are on average 10 per cent higher than for the BBC. Whilst this is a small group, operating in most cases in very different markets, the comparison is instructive, and we intend to continue to gather data on both the level of remuneration within these organisations and the policies which shape these levels. Channel 4’s remuneration policy, for example, references benchmarking against ‘those salaries and benefit packages prevailing for executives of comparable status in the television and the wider media industry, but without any of the share option schemes available to executives at most of Channel 4’s commercial competitors’.

³ Tote, TfL, Network Rail, Royal Mail Group, Channel 4, Nuclear Decommissioning Authority

Chart 3: Comparison of Chief Executive roles in the Commercial Public sector



Source PwC

This is a representative sample of senior commercial public sector roles and whilst the base salary of the DG of the BBC compares well, there is a significant difference in total reward, taking into account bonus and incentives and pension and benefits. This is particularly the case when comparing to the biggest, most similar organisations.

However, we also recognise that the BBC’s public funding model, as well as its market-facing activities, in many ways set it apart from these commercial public sector organisations. Chart 4 below illustrates how the BBC’s position is unique in being both funded directly from the public purse, and in facing extensive competition in its output markets.

Chart 4: Funding source and output market structure of example public sector organisations



Whilst some of these organisations may face public criticism for their executive pay, the bill is typically paid by their customers, and not directly from the public purse. In the debate around public sector remuneration, this is a substantive difference, and the BBC’s approach to remuneration must recognise both its market-facing environment and its public funding source.

The terms of reference of this review asked whether a BBC brand or public service discount can be measured, and what its role should be in determining remuneration. We can use the comparisons from Chart 2 above to estimate the currently observed ‘BBC brand discount’ for roles at various levels within the BBC. Table 4, below, shows that Exec Board total reward levels are around 60 per cent discounted vs. private sector comparators, whilst average SMI reward is at around a 40 per cent discount.

Table 4: BBC brand discount by grade level, based on estimated total reward

Band	Median Total Reward, £'000				BBC as % of:			Premium (Discount) to:		
	BBC	Private Sector	Public Sector	Comm. PS	Private Sector	Public Sector	Comm. PS	Private Sector	Public Sector	Comm. PS
SM2	114	152	108	127	75%	106%	N/A	(25%)	6%	(10%)
SM1	198	334	160	196	59%	124%	N/A	(41%)	24%	1%
Exec Board	359	969	250	553	37%	144%	65%	(63%)	44%	(35%)
DG	804	1,897	315	929	42%	255%	87%	(58%)	155%	(13%)

Source PwC

Interviews with BBC executive board members and recruitment consultants verified that the BBC brand discount exists, and reflects a number of distinct considerations which make the BBC an attractive place to work for executives:

- The scope and diversity of the professional challenge available within the BBC, including its public service ethos and values appeal.
- Quality of management team as a whole:
- Brand value, recognition of the BBC as a place of excellence and a CV enhancer, which can contribute to lifetime earnings potential beyond BBC.
- Greater perceived job security than the private sector.

However, the interviews also highlighted a number of challenges which come with working at the BBC, in particular the increased public scrutiny which may not be welcome to those who have no previous experience of this.

The nature of this consideration suggests that the BBC brand discount is likely to be highly role-specific, and for any particular role the following factors may influence the size of the BBC brand discount:

- *How ‘public service’ is the role?* E.g. documentary commissioner vs. property manager
- *How strong is the BBC brand for this area?* E.g. Director of News vs. Legal Counsel
- *How open is the role to public and media scrutiny?*

The brand discount itself relates to the BBC’s relative appeal in comparison to relevant alternative employers, for any particular role. The analysis in Table 4 above estimated the brand premium with respect to benchmarked roles in the private sector as a whole. However, our analysis has revealed that BBC SMs are characterised as belonging to four distinct sectors, with quite separate competitor organisations and labour markets:

Table 5: Four labour market sectors for BBC SMs

Sector	SM population as at 1 August 09	>10 year tenure % of SMs	SM internal promotion rate % of appointments from 06-09	Salaries > £150k % of SMs	% in Old DB Pension Scheme
Television	137	46	61	27	31
Journalism & Radio	203	77	75	9	67
Technology	52	52	54	21	46
Corporate	242	47	40	15	33
Total	634	57	65	16	45

The labour market dynamics for each of these sectors varies significantly. For example, within journalism and radio there are relatively few major players, staff turnover is low, and a job with the BBC is widely perceived as being 'top of the tree'. By comparison, in technology the labour market is global, there are many blue chip players, staff expect to move roles every 3-5 years, and market levels of pay for senior managers are consequently higher.

Internal promotion rates to SM roles also vary significantly, reflecting the balance of skills in house and externally within the various sectors. Perhaps unsurprisingly in our traditional skill areas the rate of internal promotions is high and much lower in areas where we have less of a strong legacy, ie: technology and business management. We foresee a continued need to recruit externally across the BBC to meet essential skill gaps, particularly in the latter, yet we also believe that a strong commitment from management to develop internal talent in order that more roles can be met through internal advancement will help to contain and even reduce total salary costs in the long term.

These differences in labour markets are currently reflected in the significant differences in remuneration between staff across the BBC's divisions, for example average salaries for SMs in television are around 24% higher than SMs in journalism & radio. However, the BBC has also been reluctant to fully reflect the differences in external market conditions in remuneration for staff across the BBC, which is why a single set of broad private sector benchmarks has been used to inform salary levels.

Table 6: Number of SMs employed annually over last five years

Year	Number of SMs
2009	634
2008	615
2007	612
2006	657
2005	659
Average	635

Table 6 above shows the numbers of SMs employed each year for the last five years and whilst you can see some fluctuation the number has been fairly static. The reductions in 2007 and 2008 correspond to the years in which we made significant redundancies mainly in corporate functions as part of Creative Future. Numbers have risen slightly in 2009 as we have added in some additional roles to fulfil increasing compliance activities.

4. Current context for BBC remuneration

4.1 Recent developments in public and political opinion

In the context of dramatically deteriorating public finances and greater public expectation of accountability and transparency, it is clear that all public sector organisations must prepare to revisit their spending and remuneration practices, to determine their fitness for the coming era.

The BBC has responded to this era of openness by publishing the pay and expenses for its fifty most senior executives, and this will be broadened to include the top 100 decision makers in the coming months. So far, public reaction to the BBC's expenses and pay disclosure has been muted: a BBC Omnibus survey in July this year found that those who reported that their perceptions of the BBC had recently declined (3/10 of those surveyed) were far more likely to point to repeat-rates (25%) and programme quality (22%) than to BBC Executive Expenses (11%) or Presenter/staff salaries (6%).

4.2 Commercial pressures on the BBC

A structural change of unprecedented pace and scale is taking place within the media sector. The BBC has built up the skills needed to reinvent itself for the digital age by developing current staff and through attracting people with the expertise required.

As the pressure grows on the BBC to innovate at the pace of the market, the need to attract specialist technical skills will only increase. In some cases, such skills and expertise can be secured through short term contracts and consultancy work, however in many cases it is demonstrably more efficient and effective to bring these skills in-house. A policy which prevents the BBC from directly hiring highly-skilled staff whose abilities attract premium salaries may therefore come with significant hidden costs.

Within the market for executive talent, the economic recession has reduced earnings expectations of private sector executives, since bonuses are linked to short term profitability and long-term incentive plans are often linked to absolute share price performance. However there is no evidence that the economic downturn has resulted in fundamental change in market practices with regard to bonus awards or long term incentives. In 2008, total cash payments to executives fell as a result of bonuses either being reduced or not paying out, combined with basic salaries being frozen. However in 2009 and 2010, most organisations expect to make basic salary awards in the range 2-5% and bonus payments will be back to pre economic crisis levels. We can therefore expect to see the value of executive remuneration packages resume their long-term above-inflation rate of growth.

4.3 Are pay cuts an appropriate response to the current economic climate?

There has been much media coverage concerning reductions being made to remuneration packages of senior executives and other staff across a range of industries as a reaction to the difficult economic and trading conditions many organisations have been facing in 2008/09. It was therefore appropriate for the BBC to examine this option and to consider whether such an approach was appropriate and whether it could work for the BBC. The analysis contained within this paper has already illustrated that BBC senior managers are typically paid below their peers in the private sector and are remunerated at similar levels to senior managers in the commercial public sector. It has also demonstrated that the BBC has contained senior pay annual reviews at levels below the private sector. We therefore do not believe that we should seek to impose arbitrary pay cuts to senior management pay. As to whether arbitrary pay cuts could legally be introduced, we sought legal advice from a leading law firm, Olswang. The summary of the Olswang opinion is:

- There is no contractual right to vary the salary of Senior Managers without their consent.

- It is possible to vary such terms without consent but to do so would require the BBC to adopt a "dismissal and re-engagement" policy.
- Such a policy would likely have severe adverse employee relation issues and may trigger onerous statutory employment liabilities.
- Examples of other industries curtailing executive pay due to the recession tend to only affect Board level directors – not wider groups of senior managers.
- Where wider groups of employees have agreed to changes in terms and conditions this has tended to be as part of consultation over proposed redundancies.

In essence, the Olswang opinion is that other than by voluntary means, or in a situation where the alternatives are very stark ie mass redundancies, it is extremely difficult to make across the board reductions in salary. Where this can be done, it is not without considerable legal risk which would carry both financial penalties and reputational risk. In those high profile cases where some reduction has been achieved, ie British Airways, this has been done on a voluntary basis which removes all of the risk.

This legal opinion, viewed through the BBC's own situation and combined with remuneration levels that are already below what our employees could expect to earn elsewhere, has led us to conclude that any form of across the board or selective pay cuts are not an appropriate way forward and therefore this action is not recommended.

5. Recommendations

Research into good remuneration practice tells us that to be effective a remuneration strategy policy and strategy ought to:

- Be clear and easily understood
- Be aligned to the strategy of the organisation
- Enable the organisation to attract, retain and motivate the right people to deliver the organisation's goals
- Balance the demands of the various stakeholders (shareholders, governance bodies, customers, management and staff)
- Focus the management team on short, medium and long term success
- Feel fair and equitable
- Be implemented with rigour and well managed

Our current remuneration strategy meets some but not all of these goals and the challenge of balancing the demands of our various stakeholders is proving to be particularly difficult in the current economic and political climate.

The BBC's Remuneration strategy states that we will "offer remuneration that attracts, motivates and retains the key talent required to lead the BBC and to deliver outstanding public service broadcasting whilst recognising the BBC's status as a publicly funded corporation which must deliver value to the licence fee payer."

In practice this equates to the BBC having the best producers, commissioners, editors, broadcasters, media technologists and business leaders that are available in the market. To continue to deliver the level of excellence to the licence fee payer in the range of services we provide we need the talent that is capable of doing that at the highest level.

Our challenge is to do all of the above and at the same time ensure that our remuneration practices do not undermine the trust and confidence of the very public that we seek to serve. Moreover, like many other organisations, we have a legacy of a number of anomalies that we would like to address but which are very difficult to remedy quickly and without damaging consequences.

We believe that ultimately our remuneration strategy must be for the medium term which we anticipate to be a period of low to zero inflation and of competitor decline in a number of the markets in which we operate; followed by a period of consolidation and market recovery and of revived remuneration inflation, albeit at less rapid levels than hitherto. It is our view that any remuneration strategy for the BBC should seek to balance our ability to recruit and retain critical and talented senior, be sensitive to the current economic climate, without damaging the BBC's ability to deliver quality output to an even wider range of audiences.

Our recommendations are set out below:

5.1 An improved market strategy

We believe that we should continue to see the commercial sectors of television, technology, journalism and radio and corporate businesses as our talent pools and that we therefore need to continue to connect to them from a remuneration perspective. However, in future we would disaggregate our benchmarking data into these four sectors and develop a more granular remuneration approach for each to reflect their nuances and varied remuneration levels. Furthermore, rather than solely benchmarking against the median of base salary, we will recognise and make explicit the BBC discount factor by having a new stated policy of being well below the private sector median levels for total remuneration. Our proposed ranges for our discounts would be:

50-80% of commercial sector comparators' total remuneration for Executive Directors
30-50% for SM1s
20-30% for SM2s

So, except in exceptional circumstances where market conditions might dictate otherwise, anyone joining the BBC from the commercial sector in a comparable role would typically be giving up between 20% and 80% of their actual previous total income every year. This explicit discount would have the effect of reducing the remuneration benchmark for a number of senior manager roles and retaining the current levels for others. However, we must always have sufficient flexibility to attract the very best and most able candidates to our most critical roles and it is possible that in a very small minority of cases, where we currently find it hard to attract quality staff (eg: some roles within FM&T) it might actually increase salary levels.

In addition, we would benchmark each Director role with equivalents in the Commercial Public sector, as discussed above, and will aim to position them within 80 - 120% of median for total cash.

Furthermore, we will work with our advisors to identify how, if possible, we might incorporate the value of an individual's pension into our benchmarking data. This would then be used to assess true market comparability.

5.2 Revised role replacement process

We recommend the introduction of three clear steps each time a senior management role becomes vacant:

- i) Review whether we need this role to be replaced or whether we could use this as an opportunity to re-structure and reduce senior management levels

- ii) Review whether the role could be altered to a lower grade and salary package
- iii) Review whether we would need to pay the same level as the incumbent or whether the salary could be reduced

It is our intention, in the current economic climate, to reduce a significant number of senior managers' salaries at the point of appointment, recognising that this will not be universally feasible due to market pressure on specific roles.

5.3 Remove internal relativity impact

We recommend the removal of internal relativity across Divisions as a key consideration for salary level setting. The desire for greater parity of remuneration at senior levels has led to a few senior management salaries rising higher than the external market comparisons for that role would suggest was necessary. Whilst philosophically quite tough, a policy which is market facing will lead to greater discrepancy between disciplines. This needs to be communicated carefully and will need to be monitored to ensure that this two tier system doesn't create internal divisions, but we believe this will enable us to reduce salaries over time in those areas where external competition for talent is static or declining and in which therefore we should not expect to encounter labour market inflation.

5.4 Increase the level of internal promotion

The BBC has always prided itself on its strong track record of career development as a result of appointing from within. However, over the last 10 years, there has been a conscious effort to enhance the senior management skill base from without – particularly in areas where we needed to improve capability such as business management disciplines and new technology. Our average internal promotion rate over the past three and a half years stands at 65% of all SM vacancies (although this varies by sector). As much of our salary inflation derives from external appointments, we will increase our efforts to ensure we have the talent to promote from within. Whilst we will not compromise on getting the best person for the job, we will intensify our approach to succession planning at all levels of senior management and will invest further in the long term career planning and management of our high potentials.

We aim to increase our internal promotion rate to at least 70% within three years, resulting in reduced recruitment expenditure. This approach will make a significant contribution to the overall goal of reducing the total cash paid to senior managers over a four year period.

5.5 Education of Directors and Senior Managers

Our current approach relies heavily on BBC People acting as monitor and final arbiter of senior management salary levels. Whilst this high level of control is paying dividends,⁴ ultimately we need all leaders in the BBC to understand the rationale for our change of approach and to actively support it. This will necessitate an education programme to help managers understand the remuneration strategy and outcomes we expect them to deliver in the negotiating and setting of pay.

5.6 Reductions in the number of Senior Managers

The BBC is a large and highly complex organisation and as such has a significant number of senior managers. However, we do believe that we should review the volume of senior managers as a percentage of total staff and we should reduce the number of roles at this level. Any reduction in the number of senior managers will be dependent upon changes to operational delivery, organisational

⁴ Since this approach was introduced in May 2009, salaries have typically been set at 15% below previous incumbent levels

design and/or strategic direction and will be managed in a coherent manner without putting the organisation at risk. We do not believe there is a case for an immediate restructuring or reduction of numbers but we do plan to reduce the number of senior manager roles by 18% by August 2013. We believe it will be possible to achieve this through a combination of natural churn, some restructuring and by carefully managing the resources currently working on significant projects which are due to end before 2013. Our early plans project a profile of reductions which will be back-ended to 2012/13, enabling them to be tied into any operational reductions arising from the strategic review work now underway. We anticipate a higher level of reduction from corporate roles than from the output areas but would expect reductions to occur across all departments and divisions.

5.7 Short term actions

We believe that the recommendations listed above will deliver our goals and will be consistent with good remuneration practice. However, we recognise that immediate steps that demonstrate we understand the current climate faced by our peers and by our audiences are also appropriate. We therefore propose to freeze all Executive Directors' salaries for a further three years ie no increase until August 2013. This will mean an annual reduction in total cash of around 8.7% in loss of bonus and a net decrease in pay in real terms of circa 7% based on the current HM Treasury predictions for RPI over the next four years. This is in addition to the loss of annual bonus and salary freeze already experienced by Directors this year. In addition, we propose to freeze senior managers' salaries for a further year ie no increase to be made before August 2011, and an extension of the bonus freeze for senior managers for a further 2 years, subject to a further review of bonuses in 2011.

The proposal to freeze salaries and indefinitely suspend bonuses for Executive Directors and to freeze both salaries and bonuses for senior managers has been made in the context of public concern around senior remuneration levels in both the public and private sectors, low RPI forecasts and a relatively depressed market for media employment.- If circumstances change and we find we are unable to fulfil one of the key objectives of our remuneration policy, ie: to retain the key talent required to lead the BBC, we would review with the Trust the appropriateness of our decision to freeze the salaries of Executive Directors and to freeze both the salaries and bonuses for senior managers

5.8 An annual review of the Remuneration strategy with the Trust

We believe that defining explicit talent-related goals for the BBC's remuneration policy would help to align the EBRC and the Trust RAC around the best policy for delivering overall performance.

Example metrics might be to:

- attract 90-95% of its first choice external candidates for SM roles
- retain 90-95% of its high potential leaders
- retain 90-95% of its SM "critical role holders"
- maintain an SM turnover of between 8% to 13%
- promote between 60 and 70 per cent internal candidates

These measures are illustrative, and would in practice be developed by the Trust RAC, with support from BBC People.

Such alignment around specific, measurable goals might help to overcome the natural and inherent tension regarding remuneration between the BBC's management, its non-executive directors and the representatives of its shareholders. These measures would be published, as part of our continued policy of full transparency around executive remuneration.

5.9 Overall recommendation

By implementing all of the above recommendations, it is our intention to reduce the paybill as at 31 July 2013 for **Executive Directors and Senior Managers** by 25% compared to the paybill for the same group as at 1 August 2009. If the full effects of the Government predictions for inflation are taken into consideration the reduction in real terms will be more than 30%. We believe this is achievable without damaging the BBC's ability to produce high quality output and at the same time effectively and efficiently manage the organisation. However we do intend to keep progress against this target under close review and will make additional recommendations to the Trust should we believe different actions become necessary.

6. Summary and conclusions

The BBC has chosen to follow a market led remuneration strategy in recent years. It has attempted to attract, retain and motivate the best that the media, technology and corporate sectors can provide and has done this through offering packages that are between 20-80% lower in terms of total remuneration from that of the private sector.

The consequences of a market led strategy in a period of prosperity for the economy and the media and technology sectors has been an escalating pay bill as the BBC attempted to remain competitive for talented individuals. Moreover, the desire to maintain internal relativities across the BBC has almost certainly led to unnecessary inflation in certain areas where we lead rather than lag behind the market

Underpinning our ability to attract the most talented people at significantly below their earnings potential and our ability to retain staff is the higher sense of job security and advantageous terms and conditions that prevail at the BBC. The final salary pension scheme (closed to new entrants since November 2006) and the greater certainty provided by the licence fee means the BBC can remain competitive for senior managers even at significantly discounted remuneration packages.

Over the last 18 months the economy and the media sector have both suffered and indications are that the median total remuneration will gradually decline as bonuses and share-related payments diminish. Political and media calls to reduce BBC executive and management pay are currently dominant headlines and the BBC must ensure that it does not erode public confidence and trust through ignoring these. However, it must also recognise that a short-term aggressive response and adaptation of remuneration to levels that lead to a loss of great people and prevents the BBC from attracting talented leaders in the future will have an equally negative impact on its audiences.

We believe the recommendations laid out in section 5 lead to a significant reduction in executive and management remuneration without fundamentally damaging the BBC's ability to attract, retain and motivate the resource that delivers excellence in public service broadcasting – its people.