Browne Jacobson

Executive pay setting in school trusts

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For many years now the Education and Skills Funding Agency (ESFA) have written to academy Chairs asking for justification and rationale on executive pay. As executive pay decision making has become trickier, school trusts have reached out to us for advice to help them meet their obligations within the Academies Financial Handbook.

Over the last two years we have advised over twenty-five school trusts on the setting of executive pay. Every project is different because no two school trusts are the same. We take the time to understand the context of the trust, the level of challenge, the organisational structure and distribution of leadership. We look at geography, the strategic plan, past growth, future planned growth and, of course, performance indicators. If so much information is required to follow a robust and evidenced based process in regard to executive pay setting, then is it appropriate to assess pay against a rigid pay threshold? When these letters arrive, the Chair has to produce lengthy responses justifying the salaries awarded to their leader(s). Despite these lengthy responses, the Trust can still be 'named and shamed' by the ESFA and press attention duly follows. It is a frustrating situation for the leaders and the Board.

The historical approach to executive pay setting

For many years' academies were given freedom to set executive pay with little regulation, steer and advice. In the beginning, Boards would make pay decisions in line with the School Teachers Pay and Conditions Document (STPCD). As Headteachers, have become Executive Headteachers and then become CEOs and as school trusts have developed and grown in size, pay decisions have undoubtedly become trickier. Alongside this, the ESFA have increased regulation but provided no advice, direction or support to Boards to get decisions right, instead there are letters asking for lengthy justifications, penalisation in CIF bids and 'naming and shaming' publicly.

The ESFA appear to be working to a pay threshold for executives in school trusts and given the complexity surrounding executive pay this is extremely simplistic.

Factors to consider when setting executive pay

The annual pay review for the CEO in any substantial business is a major exercise every year. Performance is thoroughly taken into account and the Board bring in expert advice to help decide what the CEOs bonus might be or what the increase to base pay could be. School trusts are complex organisations and the largest trusts are significant business with similar turnover to household names in the corporate world. Pay thresholds as currently in the academy sector are arguably not realistic. Without greater flexibility they won't promote strong performance and they could well discourage talent from wanting to lead school trusts.

In addition to the context, we consider the forces that exist in the sector that are driving salaries. As Leora Cruddas, CEO, Confederation of School Trusts (CST) pointed out in her email bulletin to CST members on 4 September 2020, there are a number of pay arrangements that are within the gift of the government that force salaries upwards in the academy sector, beyond £100k and the STPCD is certainly one of them. As Leora rightly pointed out:

1. "Parliament sets Headteacher pay for Local Authority (LA) Maintained Schools.

2. The Government sets the employer contribution rates for the Teachers' Pension Scheme and Local Government Pension Schemes.

3. The Government sets the employers NI contribution rate.

4. The combination of Government decisions sets the total remuneration cost for the highest paid Headteacher outside of London at £185,000.

5. The ESFA has decided that a total remuneration package of £100,000 is in the 'High Executive Pay' bracket for any employee in the Trust, whether they are a school leader or a Trust leader. That is almost a half of what the government considers appropriate pay for a headteacher of a large maintained school in challenging circumstances."

Traditionally, if an organisation is embarking on a new reward benchmarking exercise, you start with the CEO. You assess the most senior executive post and then you move to the next level down and then the next level down and so forth. The problem with school trusts is that a headteacher could be two or three levels below the CEO and if you have a Group 8 school in your trust, in inner London, then you could have a Principal earning up to £125,098 per annum in 2020/21. For the rest of England, a headteacher in a Group 8 school could earn up to £117,197 per annum (2020/21). This presents a pressure in the reward structure in a school trust to ensure that there is appropriate distance between the Principal level in the organisation and the next level up and so forth.

Whilst it's not unheard of, it's a rarity to find someone in an organisation earning more than the CEO. Where it is found it is usually due to TUPE or legacy and is mostly identified in high performing sales executives in the private sector, earning extraordinary bonuses. It would be inappropriate for a school Principal to earn more than the CEO.

Many Boards have found different ways to determine the salary level for their executives. The Academies Financial Handbook expects Boards to follow a robust and evidenced based process but what does that mean in practice? Some Boards will gather together their own salary information from various sources, via contacts in local trusts or via some other means.

Some use salary survey data to determine the salary level by working out what the market expectation is for an executive role in an organisation like theirs. Other Boards will simply have a discussion to decide what they think is appropriate. The Board should ask itself if the route they follow will withstand public scrutiny and will meet the test of robust and evidence based. It is unlikely that a simple board discussion will cut it. Whichever route taken; Boards should consider how much evidence it has available to justify pay decisions.

Gathering your own data for benchmarking can sometimes lead to the comparison of pay, trust to trust. A Board may compare the pay for their CEO to the pay earned by another CEO in a different trust. There is a real danger in placing too much emphasis on another CEO's salary when you don't know how robust or evidence based the process was that determined it. In effect the Board will be relying on another Board's process and decision making, which could be flawed. For this reason, it is important to have multiple sources, ideally anonymous so that discussion is based on market expectation and median averages.

Things to consider

Setting executive pay is not simple, a threshold is inappropriate and there are complexities to navigate. Therefore, it's important that Boards understand this and the process at the outset. The Chartered Institute of Personnel and Development (CIPD) have questioned the effectiveness of remuneration committees (all sectors) when it comes to the setting of executive pay. The UK's Corporate Governance Code stipulates that boards create a culture that aligns with company strategy, and to assess how they preserve value over the long-term. This is similar to the expectations of the Academies Financial Handbook. Boards should consider training before it begins the discussion about executive pay and perhaps also consider bringing in a specialist external advisor just as it might bring in an external advisor to deal with performance appraisal. Regardless it is important that everyone is clear on eth process and procedures that will be used at the outset.

- Boards shouldn't consider CEO pay or wider executive pay in isolation. It should consider pay across the wider workforce to ensure that executive/CEO pay is not inappropriate, and that executive pay and benefits is not increasing at a faster rate than that of teachers, in individual years and over the longer term. It is also important for Boards to consider the future and whether salary now has scope for growth should the trust grow larger in size. Whilst CEO pay is not linked explicitly to the number of academies in a trust, certainly in the early days of a school trust forming, pay is likely to increase with the growth and development of the trust. At some point growth will not be as important when determining pay and other factors will be taken into account instead. Whilst there should not be a ceiling on pay, it should not exponentially increase to the point where it is disproportionate. Pay should also not be so high when a school trust is small so that there is little room for growth as the trust grows and develops.

- Consider if your school trust is caught by the requirement to publish the difference between CEO pay and the pay earned by an average member of staff. 2020 is the first year where UK organisations meeting certain thresholds are being required to publish this information and therefore it is the first time that businesses, in particular, are really being held to account on executive pay. As a result, pay ratio reporting will increase scrutiny on pay and reward practices in the UK generally. With this change, organisations will also be required to provide a supporting narrative to explain the reason behind the difference in pay.
- Consider a greater level of transparent reporting on executive pay and performance. As already mentioned, there has always been interest in high pay and the press will have easier access to this information as a result of the recent requirement to publish the detail concerning pay above £100k on school trust websites. This may mean that press interest is inevitable regardless of whether the ESFA share the list of school trusts receiving letters or not. If your trust appears in the press connected with an executive pay story, then a greater level of transparency should go some way to help explain your version of the truth should a journalist or a member of the public visit your website. Our advice is that great amounts of detail is not needed especially when a lot of it is likely to be confidential, simply a statement from the Board giving a high-level explanation of its approach to executive pay setting should be sufficient. Listing key achievements will also help to demonstrate value for money.
- In general practice, when it comes to the value that CEOs offer to organisations and the way such high pay is justified, the contribution the CEO makes to a company's share price is often cited. The CIPD has asked organisations to ensure they truly understand what drives success in their organisations, and how much top executives contribute to this. Trust Boards should be able to cite evidence of the value that the CEO brings to the school trust, along with other executives. A robust appraisal process should contain detailed objectives aligned to the trust's overarching strategic plan. Performance should be measurable and regularly reviewed. A Board without this evidence is going to find it difficult to justify value for money when challenged by the ESFA, auditors or members of the public.

Conclusion

In summary, it's not clear that the 'naming and shaming' of Trusts receiving letters from the ESFA linked to pay above a certain level has had any positive impact over the past few years. It seems to cause more harm than good overall. Nonetheless, the general direction of travel with executive pay in the UK (regardless of sector) is that there is a drive for greater amounts of transparency and remuneration committees should appropriately skill-up or bring in external advice so as to ensure that the process, methodology and decision making is worthy of the transparency. The Board should consider if it is in the best position to share its version of the truth and whether the detail behind these decisions is sufficient to withstand public scrutiny when challenged.

It is also worth taking a step back to reflect that the process and the way you apply it on setting executive pay may be used by others as a proxy for how effective governance is at the trust and whether or not the trust lives its values. Put another way, an effective executive pay process not only addresses the ESFA direct concerns, fairly rewards senior leaders but it also can demonstrate the effectiveness of the trust's governance and demonstrate the organisation's values in practice.

For further advice on executive pay please contact Emma Hughes or Tom Wallace.

Contact

Emma Hughes

Partner

emma.hughes@brownejacobson.com

+44 (0)330 045 2338

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