GRG Remuneration Insight 93

Boards are Underpaid

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Introduction

GRG has undertaken analysis which indicates that fees paid to non-executive directors (NEDs) are significantly lower than remuneration for the equivalent executive contribution. Although this is acknowledged to be an area of concern by many NEDs, Boards are usually reluctant to tackle it for obvious reasons. Nevertheless, it is an important issue that needs to be addressed given the increased value-add expected of NEDs, their resultant amplified workloads, and the high level of personal risk exposure that comes with the role. Additionally, in recent years proxy advisors have been pressuring NEDs to not take on too many NED roles, by recommending against the re-election of some, making "overboarding" (as it is called) an area of focus.

Assessing the Reasonableness of NED Fees

The most commonly used method of assessing the reasonableness of NED fees is to benchmark a company's NED remuneration practices against those of a sample of comparable companies. This approach, in effect perpetuates current practices and does not identify when a step change is required or the magnitude of that step change. Whilst in the past the role of NED may have been seen by certain groups as often being a free lunch, or by others as a retirement plan for members of the boys club, it has never been clearer that NEDs have significant accountabilities and face material risks in fulfilling them that require high calibre professionalism. The highest calibre in fact. However, NED fees have not adjusted to this new age of director liability and independent advice, and a step change may be overdue.

In view of the above, Godfrey Remuneration Group (GRG) identified the following alternative approaches to assessing the reasonableness of NED remuneration. These were by reference to:

a) the total quantum of NED fees compared to the total Fixed Pay of Managing Director/Chief Executive Offer (MD/CEO) roles, and

b) the per diem rate of NED fees compared to the per diem rate of MD/CEO Fixed Pay.

The rationale for using MD/CEO remuneration as the benchmark is because collectively NEDs are at least as responsible as the MD/CEO for the near and long term viability of the company, and individual NEDs should be of a similar calibre to the incumbent of the MD/CEO role. These approaches and the analysis results are discussed below.

Total Quantum of NED Fees

This approach compares total NED fees with the Fixed Pay of the MD/CEO role. We elected to use Fixed Pay (instead of the total remuneration package) for comparison because it is a conservative approach and because the view was taken that the Board, as a whole, should make a comparable contribution to that made by the MD/CEO in terms of setting the strategic direction of the company and ensuring its ongoing viability (the core of the MD/CEO role for which they are paid a fixed sum). On the other hand, the operational execution of the company's strategy is mainly the domain of the MD/CEO, and rewarded with incentives.

Recognising that MD/CEO Fixed Pay and NED fees increase as company size increases it was decided to use:

- company size bands expressed in terms of market capitalisation ranges,
- the P50/median of Fixed Pay practice for MD/CEO roles for each company size range, and
- the P50/median of the sum total of NED Fees for each company size range.

The results of this analysis are shown in the following table.

All Industries			
Market Capitalisation Range	**MD/CEO Fixed Pay P50**	**Total Remuneration for NEDs P50**	**Increase Required for Total NED Remuneration P50 to Equal CEO Fixed Pay P50**
>$10b	$2,396,000	$2,423,000	-1%
$5b - $10b	$1,884,000	$1,811,000	4%
$2b - $5b	$1,394,000	$1,233,000	13%
$1b - $2b	$1,112,000	$790,000	41%
$500m - $1b	$751,000	$684,000	10%
$250m - $500m	$655,000	$464,000	41%
$100m - $250m	$559,000	$404,000	38%
$50m - $100m	$470,000	$252,000	87%
$25m - $50m	$398,000	$207,000	92%

Per Diem Rates of NED Fees

This approach compares the per diem rates paid to NEDs with the per diem rate of Fixed Pay for the role of MD/CEO.

The method used to calculate the NED fees per diem rates was to divide the annual board fee disclosed at the end of the year by the expected number of days worked per year. The method used to calculate the per diem rate for MD/CEO Fixed Pay was to divide the P50 of Fixed Pay by the number of work days per year.

The results of this analysis are shown in the following table:

All Industries			
Market Capitalisation Range	Per Diem Rate for NEDs P50	Per Diem Rate of Fixed Pay for MD/CEO Roles P50	Increase to Bring NED Per Diem Fee Rate up to MD/CEO Per Diem Rate
>$10b	$6,535	$10,417	59%
$5b - $10b	$4,444	$8,191	84%
$2b - $5b	$4,212	$6,061	44%
$1b - $2b	$3,447	$4,835	40%
$500m - $1b	$2,738	$3,265	19%
$250m - $500m	$2,433	$2,848	17%
$100m - $250m	$2,289	$2,430	6%
$50m - $100m	$1,991	$2,043	3%
$25m - $50m	$2,036	$1,730	-15%

Commentary

The following comments are made in relation to the foregoing analysis:

a) The analysis of the total NED fees relative to the Fixed Pay of the MD/CEO role was also undertaken for the three industry groups being: Industrial & Services, Resources and Financial Services including Real Estate. While there were differences between these sectors, the trends evident in these sectors were consistent with the broad trends revealed in the All Industries analysis presented above.

b) The Fixed Pay for MD/CEO roles increases at a lesser rate than increases in their total remuneration packages (TRPs, which includes incentives) as company size increases which is an indication of an increasing focus on performance related variable pay. This aspect may be a contributor to the observed outcome of total NED fees being closer to the P50 of MD/CEO Fixed Pay in larger companies, than in smaller companies.

c) Consideration was given to using the total remuneration of MD/CEO roles rather than Fixed Pay. While there were arguments for and against using both remuneration aggregates (Fixed Pay and TRP), there was an inclination to start with Fixed Pay but to also recognise the issue raised in point b) above.

d) The approach used to calculate the per diem rates of NED fees most likely underestimates the amount of work undertaken by NEDs in smaller companies as they often undertake work that should be undertaken by executives without receiving additional remuneration.

e) The analysis used in this GRG Remuneration Insight is, in our view, appropriate for determining when a step change needs to be considered for NED fees and serve as a guide to the magnitude of the step change. However, for ongoing setting of fees (and certainly benchmarking) it may not be appropriate as it would create a conflict for NEDs when setting MD/CEO remuneration as they would be seen to have a vested interest in the outcome.

Conclusions

From the foregoing analysis it appears that:

1. The practices of companies in the $1b to $2b market capitalisation range represent a pivotal point as both approaches to the analysis suggest that a 40% NED fee increase is warranted.
2. For companies larger than $2b in market capitalisation the per diem analysis suggests that larger increases in NED fees are warranted. Whereas, the total NED fees analysis indicates that smaller increases may be warranted. However, we refer to Comment b) above as an explanation for this discrepancy.
3. For companies smaller than $1b in market capitalisation the total NED fees analysis indicates that larger increases may be warranted whereas the per diem analysis suggests that smaller increases in NED fees are warranted. Comment d) in the foregoing section above would suggest that increases that would lie between those indicated by the two sets of analysis may be warranted possibly up to the 40% indicated by the results for the $1b to $2b group. It should also be noted that larger companies tend to pay committee fees and that these can form a significant part of NED total fees. In smaller companies the committee work tends to be rolled into the fees paid for the Main Board and therefore the Main Board fee policy analysis that underpins this is capturing more of the workload.
4. In the light of the above, GRG's view is that increases of between 20% and 40% of average NED fees should be considered by high calibre and active Boards even if not justified by traditional market benchmarking analysis against the NED fee practise of their peers. However, such increases may need to be phased-in.
5. Of course, if large NED fee increases are to be considered then it will be important for the composition and performance of the board to be critically reviewed. This is because shareholders are more likely to find increases acceptable when the board and individual directors are held in high esteem or board refreshment is underway evidencing progress towards a higher quality and more engaged board.
6. Moreover shareholders and other stakeholders are more likely to consider increases in the form of equity remuneration because such an approach does not involve additional cash outflow and improves the alignment of the interests of NEDs with those of shareholders. One approach that should be considered would be to provide the increases in the form of equity remuneration. Such an approach does not involve additional cash outflow and improves the alignment of the interests of the NEDs with those of other shareholders.

   This emerging trend is in response to changes to the ASX Corporate Governance Council's Principles and Recommendations (the 3rd edition being supportive of NED equity), and heightened expectations that Boards implement a NED Equity Holding Policy requiring NEDs to acquire equity. Doing so on market is often seen as problematic both internally and externally. In addition it is a very tax effective method of remunerating NEDs. See GRG Remuneration Insights 61 and 88 or call GRG for more information on NED equity remuneration and associated plan development.
7. Of course, before implementing fee increases it may be necessary to obtain shareholder approval for an increase in the aggregate fees limit (which includes grants of equity).