Life in the Boardroom

Notes from the seminar at the RAC on 17 May 2016

MM&K and Preng & Associates hosted a breakfast seminar for chairmen and non-executive directors at the RAC on 17 May 2016. It was attended by 60 people. This note summarises the presentations and subsequent discussions.

Findings of the 2015 Life in the Boardroom Survey

Jonathan Brigginshaw of MM&K began the seminar with a presentation which covered:

1. **The Life in the Boardroom survey 2015, the participation and composition of the survey as well as the timetable for the 2016 survey**

   MM&K produces a unique survey that collects data directly from directors themselves, the data is then analysed for the annual Life in the Boardroom report. The survey aims to provide an accurate representation of the current boardroom practices and allows the directors to shape the progress of the survey. There were 285 participants in the 2015 survey. In April, we conducted a market research survey in which we asked directors for their opinions on the 2015 report and ideas for the 2016 survey content. Of the 200+ respondents, 80% stated that they would be interested in participating again in 2016.

   The invitations for this year's survey are going out in July shortly after the EU referendum; the questionnaire submission deadline is in September for the full report, to be published in December.

2. **Findings of the Life in the Boardroom survey published in December 2015: movements of director fees over the last 10 years and how they compare to changes in CEO remuneration over the same period**

   - Company size appears to play a weak role in determining the level of fees awarded to Chairmen and NEDs. It may be a contributing factor, but it is not the key reason. We have yet to find the factor that explains the differences. It may come down to the preparedness and ability to negotiate fees.
   - AIM company chairmen have had an almost 100% increase in their total fees since 2005, which may be due to an increasing governance and compliance demand being placed on chairmen. AIM chairmen appear to have done better than their NEDs over the 10 year period.
   - Increases in Chairman fees in small cap companies have lagged behind their AIM, FTSE 100 and FTSE 250 counterparts.
   - Fee increases for NEDs of FTSE 100 and Small Cap companies have matched the increases received by their corresponding chairmen, but FTSE 250 NEDs fees have increased faster than those of their Chairmen.

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- Comparing non-executive board fees with executive director salary, we found that increases in chairman and NED fees have outpaced the salary increases received by CEOs over the last 10 years. However, when we explore CEO total remuneration realised (which includes bonus and LTIP payouts), we see that it has increased faster than Small Cap and FTSE 100 fees, and has reached a rate similar to the fee increases received by FTSE 250 and AIM NEDs.

3. Findings of the Life in the Boardroom survey: time commitments within the role and the struggle with rising demands on NEDs

Some comments from survey participants:

- "Too much time and even more energy is being taken up by governance processes, leaving too little time for conceptual thinking and strategy"
- "Some stability in regulation and legislation would be most welcome. Most NEDs need some catch up time if we are to provide the support owed to our companies"

- However, since 2007, it can be seen that the total days spent doing the job have not altered much at all for both chairmen and NEDs. In fact, the days spent in the role per year have dipped since a peak following the banking crisis in 2007/2008.

- Only 3% of NEDs' total time in the role is spent on learning and keeping up to speed with the ever-changing governance and process guidelines. Just 40% of NEDs received any form of technical subject training to perform their duties.

4. The Findings of our market research in April-May 2016

This research is separate from our main survey and is intended to enable chairmen and NEDs to have a say in what subjects they would **like** to see in our 2016 survey.

- Following the feedback from last year's market research, we designed a set of questions specifically aimed at each ownership group including main market, AIM listed, private equity owned, not-for-profit organisations and family or privately owned companies, in which we received positive feedback from 92% of the participants about the usefulness of these questions.

- With regards to the content, this year's participants were particularly interested in a selection of topics, including:
  - The level of shareholder involvement in main market listed companies
  - Environmental, social and governance demands placed on NEDs, and their impact on the role of the NED
  - The rising governance burdens i.e. red tape

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- Reporting practices and the level of disclosure in AIM company reporting
- Pay differences between not-for-profit and commercial businesses
- Use of performance related pay for the top team in charities
- Tax efficient exits for founders
- Percentage of time and cost of PR involvement in the board and business

- Overall, we found that the US fees model and the views on 2013 directors' remuneration reporting regulations were less useful to research respondents.

The evolving role of the Chairman and Non-Executive Directors – Richard Moon

Richard Moon is currently Chairman of Acal plc, Seven Technologies Holdings Ltd and Synergie Business Ltd and has a background of top management in technology industries, having been chief executive of Racal Electronics and subsequently Thales UK plc.

He began by describing the modern era of the Chairman and NED, who are prepared to challenge the submissions from the executive team, as they are independent executives with a business background. He said there is, however, no difference between the responsibilities of an executive director and a non-executive director in the eyes of the law. Directors have to represent the interest of all shareholders and the company.

But in practice an NED is there to challenge and support the executive team. There should always be a majority of NEDs otherwise they will not be taken seriously and can be outvoted by the EDs. If the NEDs are in the majority, they can, ultimately, vote the EDs off the board. But the NEDs should never cross the line to act as though they are executives (unless, for example, a chairman is forced to step in if something happens to the CEO). This can be a great temptation for an NED who is an ex-CEO. But their job is to challenge submissions from the executives, to ensure they are thought through and meet the agreed strategy.

Once a decision has been taken by the board, the directors must act collegiately – everyone must support the decision.

It is different for Private Equity owned companies. There is typically an independent chairman and one NED representing the investor. The rest of the board comprises EDs. In listed companies the Chairman and NEDs receive a fee. In Private Equity owned companies you usually get equity and can buy extra shares. You are seen as part of the investing team.

It used to be considered the short straw if the NED was asked to chair the audit committee; but now it is the remuneration committee which is in the spotlight of shareholders' attention – because of the concern about executive director remuneration and perceived greed. Shareholders expect the remuneration committee to stand up against this. Remuneration consultants play an important part in this – they provide invaluable advice about what a company can and cannot do.

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To play these roles, the NED needs a mix of skills. He or she must also commit sufficient time. Some NEDs take on multiple directorships. They need to be careful – the job can, at times, become very busy within one company alone and NEDs need to be available.

They need to have good knowledge of compliance with corporate governance codes and practices. It is also essential nowadays to have a good gender mix. Women prove themselves to be as strong as or stronger than their male counterparts – they are fearless. No wonder the role of remuneration committee chair is often passed to a woman.

NEDs do a fantastic job, but for very little money. You are paid £30k -£35K and you are not able to ask for more. And yet you are personally liable. Normally you are protected by the corporate veil of collective responsibility, but in some areas you are now personally liable, for example remuneration policy adherence.

The best NEDs will not work for the public sector because they are so poorly remunerated. They like working in Private Equity because of the provision of shares.

Ultimately, it is important to remember that NEDs and Chairmen are there to represent the interest of the shareholders, ensure the highest level of corporate governance, support the executive team in creating a winning strategy and reward executives for delivering exceptional performance, not simply achieving what they are already well paid to do.

The following views and questions were put forward by the floor – the speakers responses are shown:

- Does share ownership by NEDs impact on their independence?
    - They usually get a fixed fee and you can't stop them buying on the market.
- Does holding shares encourage short-termism?
    - Public companies would not get into that situation.
    - Very few NEDs get part of their fees in shares.
    - I don't know of any NEDs who have bought a lot of shares.
    - Shareholding in public companies has to be long term, due to closed periods etc. Any director who owns shares should be in it for the longer term and should wait a year after stepping down before selling.
    - One view from the floor was that holding shares makes you take a longer term view.
- Directors should act in the interest of every shareholder, not just the big investors.
- Section 172 of the Companies Act 2006 requires directors to act for the benefit of the company's members as a whole and to act fairly between them. It also requires directors to have regard to the interests of the company's employees,

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the need to foster relationships with suppliers and customers and the impact of the company's operations on the community and the environment.

- In the past, the CEO used to have a basic salary, a bonus (only for exceptional performance) and share options. Today, LTIPs with performance measured against a peer group are commonplace in listed companies. CEOs can amass as much from LTIP awards as from salary and bonuses. They ought to get really well paid for their "day job" and then only get the standard package unless the company is doing exceptionally well against budget or market expectations.

Discussion forum

Damien Knight of MM&K introduced a number of topics and then led a floor discussion.

1. The Evolution of the responsibilities and reward of NEDs

According to the results from the Life in the Boardroom Survey, 42% of NEDs/chairmen who participated believed that their fees were too low considering the current demands and risks involved with the role; yet the amount of time spent doing the work has not varied much over the last 10 years. Damien put these questions:

- What is the experience of the audience in the changing demands of the role?
- Is the existing board model still fit for purpose?
- Despite the statistics from our survey, is there a growing gap between what NEDs are expected to do and how they are paid?
- How could the fee model be improved?

Responses from the floor:

- Remuneration in a PE-backed company is very simple because everyone is aligned towards increasing the value of the company. In AIM and fully listed companies there is more governance and regulation and the position is more complex. How can they be aligned with shareholders?
- Companies should have a shareholding requirement for NEDs as well as executives, worth the equivalent of their annual fees after 3-4 years and held for their entire time on the board.
- The scale of bonuses for executives is worrying – they are "troubling in my soul".
- PE-backed companies are fundamentally different. All directors are aligned in the same way. Executives do not get bonuses but get a big pay day at the exit. In public companies there is no finite exit and so there is a stronger case for bonuses.

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2. Executive pay simplification

The interim report from the Investment Association Working Group on pay simplification said that the current approach to executive pay in UK listed companies is "not fit for purpose" and there is a poor alignment of interests between executives, shareholders and the company. It also opined that pay comparisons, remuneration consultants and plan complexity have driven disproportionate rises in executive pay.

LTIPs are seen as the main problem, but the Working Group is less clear on the structural solution, and so is consulting on alternative long-term alignment structures. Alternatives that have been put forward include restricted shares and share grants based on the performance at grant. Surprisingly, share options were not even mentioned. Damien put these questions:

- What does "fit for purpose" mean to you?
- Is issuing restricted shares going to improve alignment?
- What are your views on share options?

Responses from the floor:

- Is the "executive pay is not fit for purpose" claim driven by envy?
- The sums of money appear very large and it is very hard to get the quantum right. Time lags can cause difficulty. Remuneration committees must do what they believe to be right.
- Weir Group tried simplification but this was rejected by shareholders.
- Actually the situation was more complex at Weir Group. The level of awards was reduced but the restricted shares package was still generous.
- Restricted shares are superior to share options because they require fewer shares and are therefore less dilutive.
- Institutional investors all have different preferences about performance measures and types of plan. Even within the same body, there are differences between corporate governance and investment departments.
- It is right that performance conditions should be linked to the strategy of the company but this can be difficult to implement.
- Two of the leading remuneration consultancies have very different approaches for LTIP performance measures. One seems always to recommend a combination of relative TSR and EPS: the other tries to align performance measures with KPIs.

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5. **Engaging with investors**

MM&K survey findings show that only 7% of directors consider that institutional investors/participants are generally willing to consider different approaches to reward. 16% believe these investors are less willing whilst 37% say investors hold mixed views with regards to this topic. Damien put these questions:

- How well is the dialogue going?
- What are the barriers and how could the dialogue be improved?
- How can trust be improved (both ways) between shareholders and non-executive directors?
- Are there lessons that can be learned from each other by companies with different ownership models?

Responses from the floor:

- It would be welcome if more investors actually voted, even if they voted against. There may be a case for withholding dividends from those who do not vote.
- Proxy agencies create barriers between companies and investors. We need to return to proper shareholder democracy.
- Changing your remuneration is possible if you have conviction, but it is vital to communicate with shareholders to gain their trust. Materials must be clear and transparent. My company has just moved to a radical new way of remunerating. Our Remco chair is a woman who went on numerous visits to shareholders to persuade them our approach is right.

Closing observation from Paul Norris, meeting chairman

There are now increasing demands on AIM companies for corporate governance and disclosure levels equivalent to fully listed companies. MM&K will be issuing a report in the summer on this topic.

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