Revamp Non-Executive Director pay

Remuneration systems need to be simplified.
By Dr Mark Bussin

Setting a fair level of pay for non-executive directors (NEDs) is in the limelight again and we deserve clarity on this contentious issue. We all use benchmarking as the primary approach and it has served us well. Perhaps it is time to consider an “indexed” approach that is transparent and serves certain logic. This article shares possible solutions to this dilemma.

Benchmarking approach

Which set of principles should one use to set the pay level – those for executives or those for NEDs? We have traditionally looked at completely different principles for setting NED pay and, once set, we benchmark against similar size, complexity and type of organisations as ours.

Factors to consider when setting NED pay

Traditionally, some of the most important factors to consider when selecting and setting NED fees are set out below:

A. From an individual’s point of view:

- Reputation
- Track record
- Experience
- Specific knowledge and skill
- Industry understanding; and
- Network reach.

B. The role played:

- Chairperson or committee member;
- Main board;
- Audit committee;
- Remuneration or HR committee; and
- Other committees such as risk, career and succession, projects.

C. Organisation type

- Organisation size – assets, turnover/sales, number of employees, market capitalisation;
- Complexity of work/industry – single or multi product or service;
- Impact on sector, industry, national economy or international impact – impact on one sector versus the impact on the national economy is always debatable, as most would argue that they have a wide sphere of impact and influence. The decisive test is the extent to which it is nice to have or have to have, and the extent of alternatives;
- Competitors – the extent to which there are no competitors, for example, monopolies or cut throat global competition in, say, the garment industry; and
- Strategic level – this refers to the levels in stratified systems theory.

One therefore has to consider the individual, the role and the type of organisation when setting NED pay. This has led to all NEDs sitting on the main board to get the same rate of pay. When I get my board pack (which is often as thick as a brick), I go through it thoroughly – read the numbers, see if the new strategy proposed has worked elsewhere and so on. I work hard and put in a lot of effort. When I arrive at the board meeting I am ready to contribute.

My colleague sits next to me, opens the unopened courier parcel with the board pack in it and says, “Right, let’s start!” or worse, “Where is breakfast?”

Another example is when the chair of the sub-committee, a main board member fee, the CEO’s pay, and the chair of the sub-committee fee are all the same. This can’t be right, and we need to look at alternatives.

Alternative NED pay model

The traditional approach has too many subjective factors in it – especially the first factor, which considers individual characteristics. Most organisations are looking for a much simpler and robust method for setting NED pay.

The concept proposed in this paper is defensible, transparent and easy to explain. So, assuming one has set the Executive Directors’ pay correctly, this would seem to be a fair methodology. The formula used is set out in the table above and the principle is that the NED pay is set as a function of the Executive Directors’ pay. The payment to the NED would be a combination of attendance and fee per meeting.

This framework can be adapted depending on Industry type and precedent. To migrate to this model from current practice may take two to three years but, after that, it is transparent and uses a methodology with which we are all familiar.

NED performance

Performance related pay (PRP) is sweeping the globe, so why exonerate NEDs? I think that a fair PRP might look like the one shown in Table 2. This would not be linked to the performance of the company, but to the performance of the NED – thus not falling foul of governance issues.

Did not meet expectations = 1.
Exceeded expectations = 3;
Met expectations = 2; and
Did not meet expectations = 1.

The results would feed in to the payment structure for the NED. A rating of one gets the scheduled fee, two gets 10% more and three gets 25% more than the scheduled fee. Finally, there is the question: how should one pay the fees?

Structure of NED pay

The structure of NED pay takes three main forms:

- Fees for attending meetings;
- Retainer paid, say, annually; and
- Combination of fees and retainer.

Based on our research, the combination approach is the most common. In addition to this, travel and subsistence is disbursed, and travel and preparation time is compensated at 50% of the rate for the meeting, with caps on both.

Final thoughts

This area of remuneration requires the most work.

We need to be able to accommodate definitions that fall outside of the norm – like full-time independent non-executive directors, NEDs that bring in fees and those for executives or those for NEDs.

We need to simplify our remuneration systems.

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Mark will be the Closing Speaker at the HR Future Architects of Greatness Summit at Vodaworld on 22 July. The Summit is focused on calling all South African leaders to lead with greatness.

Table 1: A NED pay model as a function of Executive Director pay

<table>
<thead>
<tr>
<th>Position</th>
<th>Index</th>
<th>Pay rate index</th>
<th>Illustrative Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chair of the main board</td>
<td></td>
<td>100</td>
<td>R750 000</td>
</tr>
<tr>
<td>Main board member</td>
<td></td>
<td>60</td>
<td>R450 000</td>
</tr>
<tr>
<td>Chair of sub-committee</td>
<td></td>
<td>30</td>
<td>R225 000</td>
</tr>
<tr>
<td>Sub-committee member</td>
<td></td>
<td>15</td>
<td>R112 500</td>
</tr>
</tbody>
</table>

Table 2: NED Performance matrix

<table>
<thead>
<tr>
<th>Transfer of Knowledge</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mentoring</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

The performance ratings are:

- Exceeded expectations = 3;
- Met expectations = 2; and
- Did not meet expectations = 1.