

Non-executive directors' remuneration

- Changing role and pay profile

by John Egan

This article is based on material provided to the Productivity Commission in a submission on its enquiry into director and executive remuneration in Australia

The remuneration of non-executive directors has changed radically over the last forty years to respond to the change in the complexity of business, increased regulation and a major expansion of the expected involvement and expertise of members of the Board. It will be important to ensure that remuneration continues to reflect the increased risk and responsibility of the role.

The role of non-executive directors over the last quarter of a century has changed dramatically arising from the sheer scale of the leading companies on whose Boards directors serve, the international engagement of those companies, the demands imposed by various standards and the Corporations Act and the emergence of directors' engagement in specialised work of the board through committees, including Audit, Risk Management & Compliance, Remuneration & Nominations, Occupational Health & Safety and the Environment.

In the 60s and 70s, while directors had clear accountabilities, a key aspect of their role was to provide an alternate viewpoint to that of executives in relation to the conduct of the company's business interests and to be a further, though independent, source of reference in relation to issues relevant to shareholders and/or in networking across key stakeholder communities, including governments, international and domestic industry bodies, professional associations and service providers.

The median and average fee for a Chairman of a top 50 company in 1988 was less than \$60,000 per annum. For a director the fee was indicatively in the range of \$25,000 to \$30,000 per annum.

At the time, the top 100 companies represented the major diversified industrial groups, resource companies, financial services, retail, transport, construction, property development and media enterprises, not distinctly different from today, though the relative weighting of the industry sectors was at variance with today's corporations, particularly the top 50 companies.

At the time, while the median or indicative value of a director's shareholding in the company on whose board they served among the top 50 companies was less than \$30,000, the average was a significant multiple of that figure. Directors serving on significantly smaller companies, that is those with revenues of less than \$50 million in 1988, on average had shareholdings with a then market value in excess of \$1,000,000, reflecting significant shareholder vendor representation on boards.

With the significant growth in major companies has come an increased level of demand on non-executive directors, both in serving as a member of the Board but also participating at a far more intimate level through committee work of the Board. With this increased engagement has come a substantial uplift in a director's time commitment and growth in fee levels required to attract suitably qualified non-executive directors.

While in the 70s and 80s directors on many leading companies received shares or options as part of their emoluments, by the late 90s as a practice this had been restricted to small market cap companies and recently listed companies. In recent years, however, Egan Associates have observed an increase in the commitment of non-executive directors to acquiring shares by way of fee sacrifice, an initiative widely endorsed by shareholders, reflecting a commitment of directors to align a proportion of their emoluments to ordinary shareholder returns.

In the early part of the 21st century activist shareholder initiatives, in parallel with the introduction of the superannuation guarantee charge legislation, persuaded the majority of leading companies to close their long established defined benefit retirement plans for non-executive directors.

At the time these provisions were not as transparently disclosed as is the case today and Board service was not expected to be in the order of ten to fifteen years but rather between two and three terms of three years.

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While the Corporations Law had provided for non-executive directors to receive a retirement allowance up to three times their final year's fees, it was noted by shareholders at the time that many plans provided for benefits (with shareholder approval) up to five, or in a very limited number of cases six, times a director's final year's fees after long service.

The underlying cost of providing these defined benefit retirement programs were in the range of 30% to 50% of a director's annual fees. Among Australia's leading companies a significant majority of these defined benefit plans were closed and the benefits crystallised, predominantly in the 2003 to 2006 financial years.

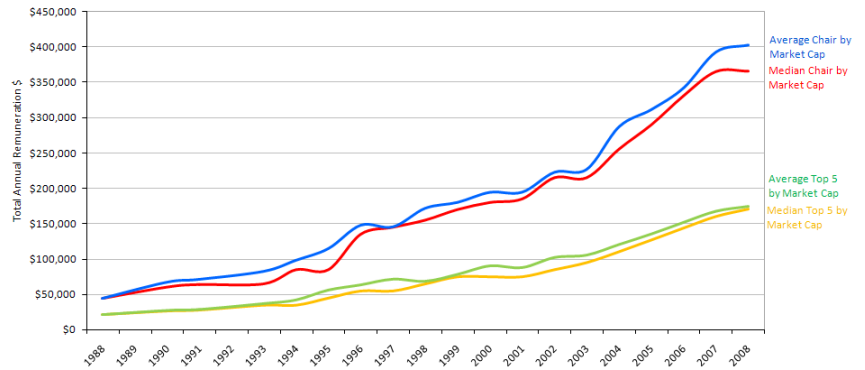
Arising from these initiatives directors' emoluments were adjusted to reflect the loss of retirement benefit, though also to more appropriately reflect their significantly increased time commitment. Accordingly, fee pools approved for distribution among directors were substantially increased during that period.

Subsequent to the above changes companies have been required to comply with the superannuation guarantee charge legislation and directors have either received an aggregate fee within which they comply with that legislation or a base fee with additional contributions being made by the employing company to meet the obligations under the legislation or comply with the spirit of those obligations.

In this context, while an increasing proportion of directors receive a contribution toward their superannuation in accordance with the limits of the legislation, a proportion of companies apply a superannuation contribution equivalent to 9% of the aggregate fees of the non-executive director. In the vast majority of cases these contributions sit within the shareholder approved fee cap, though in a small minority of companies contributions in accordance with the company's compliance with the superannuation guarantee legislation stand outside the approved fee cap.

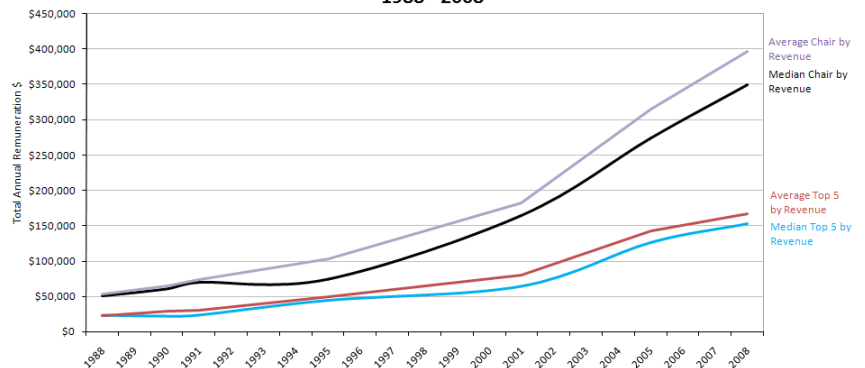
The charts adjacent provide information on non-executive directors' fees on average and at the median for both Chairmen and the five highest paid non-executive directors over the period from 1988 to 2008 among Australia's top 100 companies by market capitalisation and annual revenue.

**Annual Emoluments among the Top 100 Companies (by Market Capitalisation)
Non-Executive Chairmen and Top 5 Highest Paid Non-Executive Directors
1988 - 2008**



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Prior to 2003, Non-Executive Directors' Remuneration Bands were used. From 2004 onwards, Non Executive Directors' Actual Total Annual Remuneration were used.
Companies are ranked by market capitalisation as at 30 June of each year (and excludes property trusts, funds, overseas entities and subsidiaries)

**Annual Emoluments among the Top 100 Companies (by Revenue)
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The charts adjacent highlight the actual level of total annual cash remuneration among Australia's top 100 companies by market capitalisation over the two decades since 1988, as well as the cumulative percentage increase in the annual remuneration of CEOs, the top 5 executive, non-executive Chairmen and non-executive directors.

Of interest in relation to the top 50 companies and the top 100 companies ranked by market capitalisation is that today a Chairman's average and median fee level represents around 15% as a proportion of a Chief Executive's total annual cash compensation (fixed annual remuneration plus annual bonus) or between 20% and 25% of their base remuneration.

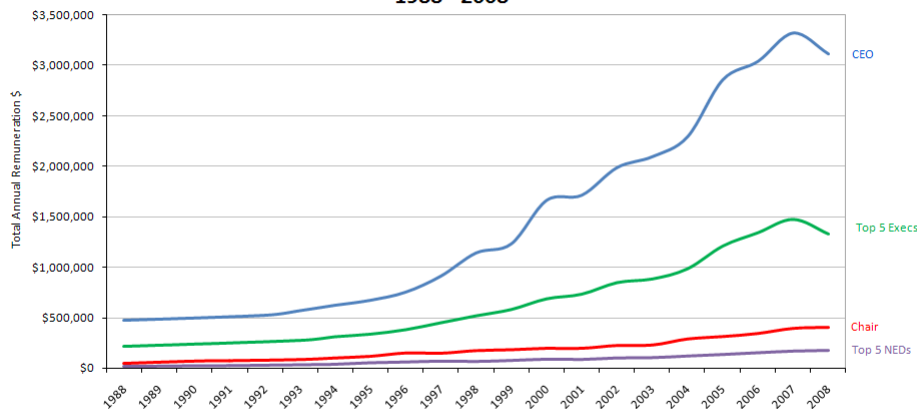
An issue which the Productivity Commission is to address is the allocation of options to the non-executive directors, particularly in start-up companies and companies with a modest market cap, usually in the technology and resources sector. A consequence of this practice, often embraced to preserve cash, is highly variable reward to non-executive directors from either a substantial windfall or a limited return.

Further issues which have been controversial over the past decade include the number of boards on which an individual should serve as a non-executive director and the importance of directors being shareholders in the company on the Boards on which they serve.

Egan Associates do not believe these are matters requiring review by the Productivity Commission. When they become important to shareholders we observe they are raised publicly at Annual General Meetings.

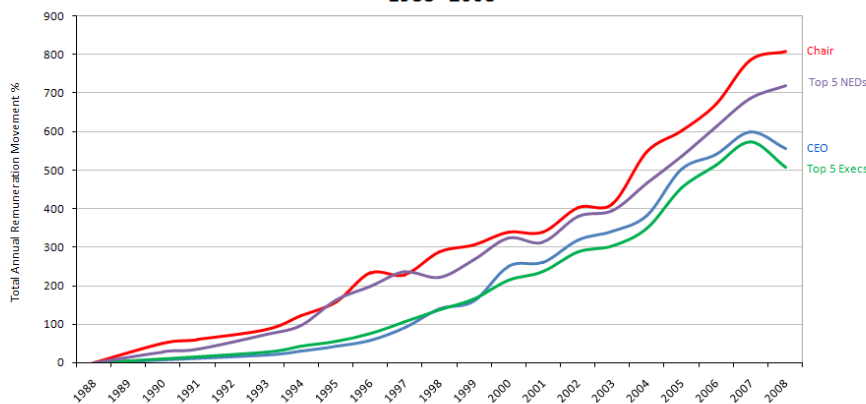
Over the past decade or more it would be our clear observation that non-executive directors have responded promptly to issues raised by shareholders in relation to their own remuneration. This is particularly evident in the closure of long established retirement plans and substitution of fully transparent emoluments, including an uplift in their cash compensation in substitution for the traditional defined benefit retirement arrangements.

**Average Total Annual Remuneration among the Top 100 Companies
CEO, Top 5 Executives, Non Executive Chairs and Directors
1988 - 2008**



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**Average Total Annual Remuneration among the Top 100 Companies
CEO, Top 5 Executives, Non-Executive Chairs and Top 5 Non-Executive Directors
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