

## **The following article appeared in Boardroom Magazine**

By Cliff Weight, Director of MM&K.

**The UK Corporate Governance Code is strongly against awarding options to non-executive directors and requires prior approval of any award of options. I always thought that the Code in this respect is wrong, so I am greatly pleased to see the new QCA Corporate Governance Guidelines for Smaller Quoted Companies which note that a non-executive director may not be independent if he/she has a "*significant participation* in the company's share option or performance-related-pay scheme".**

**The QCA guidelines reflect my own thinking. The question is the size of the options - as it is only when they become excessive that they might lead to a non-executive behaving in a way that may not be in the company's best long-term interests. However being able to offer options can help smaller, start-up and fast growth companies to keep costs down and still enable them to attract high-calibre and interested non-executive directors.**

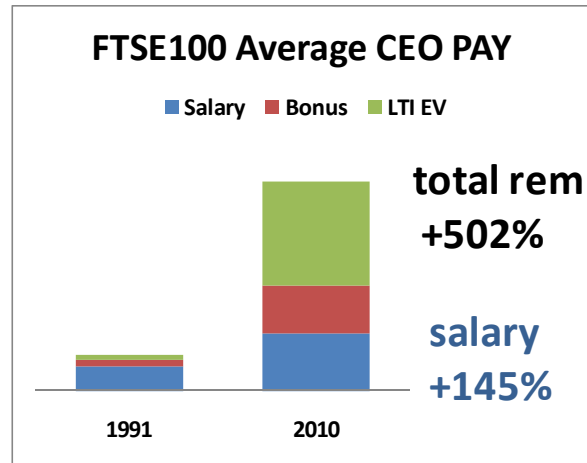
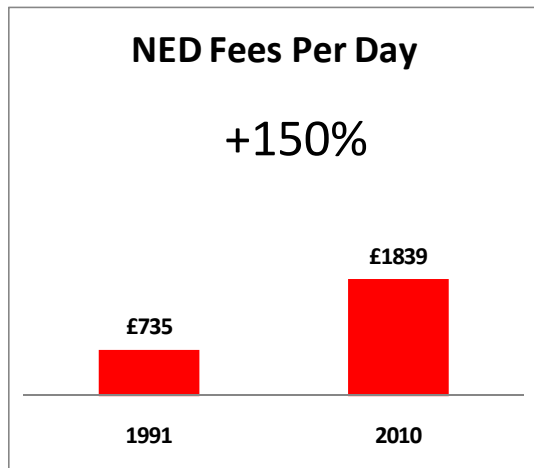
Of course, companies do not have to comply with the UK Corporate Governance Code. The requirement is either to comply or to explain non-compliance. I hope that many companies will choose to explain, by saying that they feel the QCA guidelines are more appropriate to them, in respect of the recruitment and remuneration of their non-executives.

The role of the non-executive has changed. In 1991, the median time spent was 17 days per company. When Tiny Rowland notoriously compared non-executives to trinkets on Xmas trees, many Boards would have a Knight and a Lord. Board meetings were amiable in nature and often followed by a jolly good lunch.

The role today is much more professional. Non-executives must challenge and to do so they must gain a detailed understanding of the company. They must be rigorous, and they must set the pay of the CEO and key executives.

So it is not surprising that the time commitment has doubled to 33 days per year per company.

However their pay has not kept pace with executives' total remuneration.



### What for? And How much?

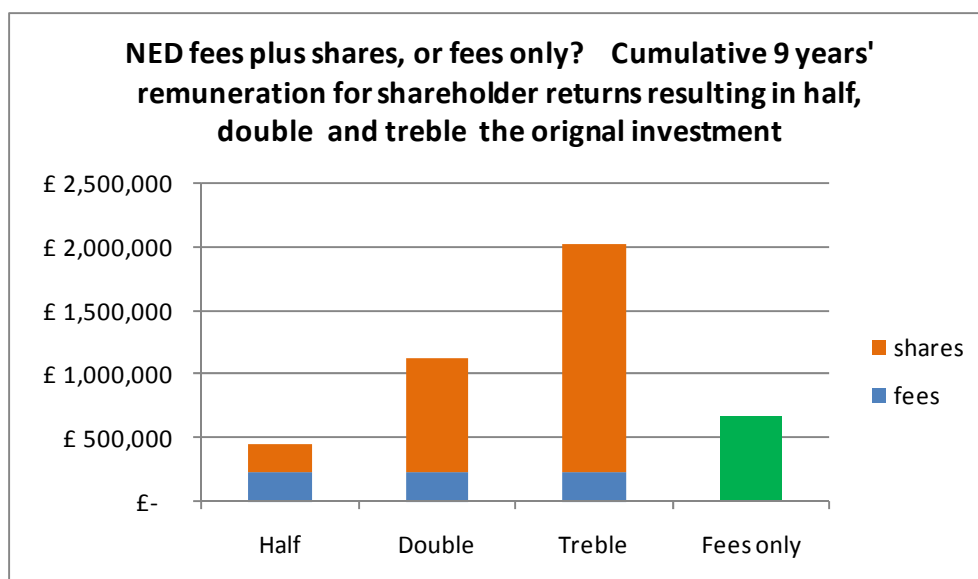
We need a debate on how much to pay non-executives and for what? I believe we, in the UK, need to pay non-executives more, but this needs to be done in a way that reflects the need for more professionalism, time input and more scrutiny of strategy and risk.

The last 30 years have seen a huge change in the way executive directors are remunerated. There has been a huge growth in performance related elements of remuneration.

Non-executive fees have broadly gone up in line with CEO salaries – which is slightly more than average wages. MM&K data for the last 12 years shows average increases of 7% p.a. for CEOs' salaries and NEDs' fees and 4% p.a. for average wages.

FTSE350 non-executives are paid differently to those in the US. Exxon, for example, pays its non-executives (they call them external directors) each year \$100,000 plus 2,500 shares, which at recent share prices were worth slightly less than \$200,000. Importantly, their non-executives cannot sell these shares until after they retire and there are rules for the phased sale of their shares. This remuneration package is designed to create long term alignment with shareholders.

A mix of fees and shares has, in my view, great merit. I modelled how much a non-executive would receive if paid a fee of £50,000 and 10,000 shares a year. I assumed the share price when the non-executive was appointed was £5. I then assumed 9 year tenure and compared this to what a typical FTSE100 non-executive would receive (£75,000 a year in fees and no shares or share options).



The outcome depends on what the share price is at the end of the 9 years as the chart illustrates.

For a typical FTSE100 non-executive director, these are not life-changing amounts. They will not prejudice their independence. However, I do believe this approach will improve the alignment of non-executives with long term shareholders, particularly if the shares can only be sold over a number of years, e.g. maximum of 20% a year for each of the first five years after leaving.

Smaller companies may want more performance linkage. For them, a mixture of options and fees may be more appropriate.

In MM&K's annual 2010 Chairman and Non-Executive Director survey, we have consistently received comments that non-executive directors should be paid in shares or options.

Our survey data shows that only about 17% of companies are paying non-executives in shares, but when they do the amounts are typically quite substantial - about half of the total. There is also some evidence that those paid in shares pay more than those paid only in cash.

Only about 20% pay in options. Where options are awarded, they can be very significant. The survey also confirms that options in private and AIM listed companies are a key component of reward in many cases.

At the end of the day companies will get what they pay for and what they deserve. If you want committed non-executives thinking carefully about

risks, long term strategy and long term success, my suggestions above should help. But always remember that pay by itself is no panacea.

The MM&K Chairman and Non-Executive Director survey is a joint venture with Russell Reynolds, the search firm. Please contact Cliff Weight at MM&K on 020 7283 7200 if you would like a copy of last year's survey.

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Cliff read Mathematics and Statistics at Cambridge. He has over 25 years' experience as a remuneration consultant prior to joining Independent Remuneration Solutions, who merged with MM&K in November 2006. He specialises in advising companies on executive directors' remuneration, annual and long term incentives and non-executive directors' fees.

He is a regular speaker at conferences and is co-author of [Tottel's Corporate Governance Handbook](#).

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