Board Compensation Trends and Challenges

By NA BOON CHONG, JACOB TAN and ABIRAMI DEVI

The world has become more fragmented, and businesses increasingly have to tackle a myriad of issues: geopolitics, climate change, financial markets, workforce matters, changing consumer expectations and emerging technologies. Corporate boards, in their roles as stewards and navigators in this complex landscape, have to be more involved and active in providing guidance. Should they be compensated more?

Directors are expending more attention, time and effort in their board roles. Post-pandemic, in a world marked by volatility, uncertainty, complexity and ambiguity, corporate leaders must keep abreast of emerging trends and challenges.

The 2022 *Board of Directors* survey by SID showed that 34 per cent of independent directors on listed company boards in Singapore spend more than 20 days a year (with a wide range of 21 to 100 days) on board work. At the other end of the scale, 35 per cent of independent directors spend 10 days or less, and the remaining 31 per cent spend between 11 to 20 days. The wide variance in time spent on the board agenda reflects the different types of boards, the time and effort required, and the calibre of directors serving on the boards.

In comparison, the 2020-2021 *Trends and Priorities of the American Boardroom* report by the National Association of Corporate Directors pointed to directors spending an average of 30 to 32 days on board work. Based on our engagement with boards of large enterprises in Singapore, we would reasonably expect them to be in line with that.

More active boards

Research by Aon on companies listed on the STI 30 index highlighted an overall increase in board-level meetings between 2016 and 2019, particularly the audit, exco and risk management committees. New committees, such as sustainability, investment and technology, were also added to the board structure. This indicates an increase in board activities and more board work is being done at the committee level, where there could be greater role clarity, sharper focus and dedicated attention.

Has the board's compensation kept pace with the increasing expectations and demands? The answer is not straightforward.

Board compensation keeping pace?

How has director compensation evolved over the past years with the pandemic-related disruption? This article focuses on non-executive directors; thus, any reference to director compensation refers to only non-executive director compensation.

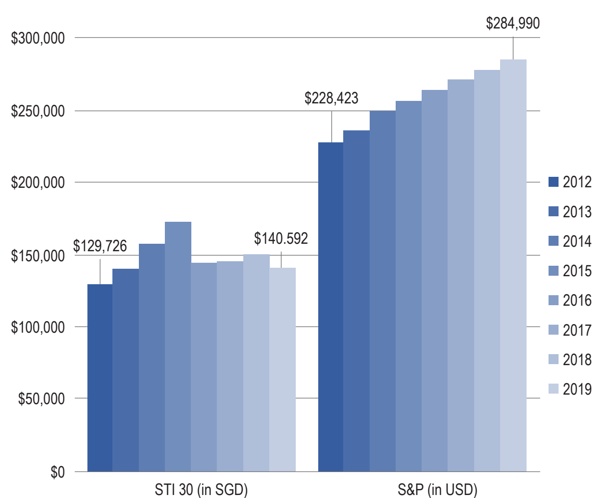
The compounded annual growth rate (CAGR) of the average director compensation from 2012 to 2019 is 1.01 per cent for the Singapore STI 30. In contrast, it is 3.2 per cent for the median director compensation for the S&P 500 (see box, "Director Compensation, 2012 to 2019").

The modest increase seems justifiable considering the increased expectations and demands on directors. Additionally, as a context, average employee salary increases have been running at 3.5 to 4.5 per cent on average for Singapore and 3 per cent for the US during the same period.

Contrasting director compensation increases with CEO compensation. Based on Aon's analysis for the S&P 500, the CAGR for median CEO Total Direct Compensation between 2012 and 2019 is 5.09 per cent. For the STI 30, it is 3.98 per cent. See box, "Compensation CAGR, 2012 to 2019".

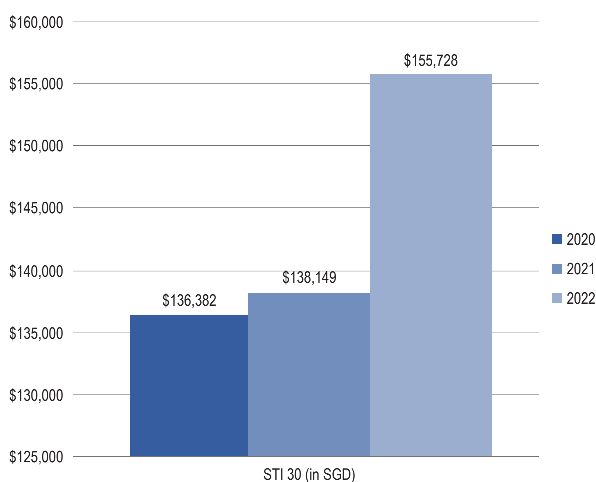
The above analyses were conducted till 2019 to exclude any temporary compensation reduction actions taken during the pandemic years. The average director compensation data shown in the box "STI 30 Director Compensation, 2020 to 2022" shows a reduction from 2019. Preliminary partial data for 2022, due to different financial year-end cycles, shows an increase. Including these three

Director Compensation, 2012 to 2019



Sources: Aon Insights (for STI 30) and ISS Analytics (for S&P 500)

STI 30 Director Compensation, 2020 to 2022



Source: Aon Insights

years' data would give us a CAGR of 1.67 per cent from 2012 to 2022, which is slightly higher than the 1.01 per cent from 2012 to 2019 for Singapore.

Other than being relatively stable over the years and with a modest CAGR, the cost of governance, as represented by total board compensation, is a small percentage of business financials. The analysis shows that total board compensation averages about 0.018 per cent of revenue and 0.144 per cent of net income for the STI 30.

Board evaluation

A more pertinent question is: Is the board adding value?

Boards typically conduct periodic board evaluations to ensure robust governance on board oversight issues and operations. In the final analysis, boards need to create long-term value, embodied in the form of shareholder value. Attributing shareholder value creation to board contribution is a confounding task even in a stable stock market, let alone in a volatile and disruptive market.

Director compensation should rise with level of workload although we would expect some rebalancing of work as a director's time is finite, such as running board operations more efficiently and thus freeing up time for strategic issues. There are also competitive pressures for scarce expertise such as investment, digitalisation or ESG.

Equity compensation could be thus one way to align directors' interests, as well as take the pressure

Compensation CAGR, 2012 to 2019

	Director Compensation	CEO Compensation	Average Employee Salary
STI 30/Singapore	1.01%	3.98%	(Singapore Market) 3.5%-4.5%
S&P 500/US	3.2%	5.09%	(US Market) 3%

off cash compensation. Equity compensation for directors is recommended to be awarded as restricted shares, i.e., time-based and vests only after a certain service period, unlike performance shares. In addition, a good practice guide would treat equity awards as a part of the total director compensation and add ownership guidelines and/or sales withholding requirements.

Director compensation comprising significant equity awards may thus not be immediately liquid, and therein lies a limitation. It may not meet the financial needs of a younger set of directors still in their prime earning years of their careers when the market demands greater board diversity and board tenures are shortened.

Another limitation is that declining share prices make director compensation in equity challenging and more difficult to recruit and retain qualified directors. Volatile share prices also make the design considerations more complicated in ensuring the delivery of a targeted compensation value without inappropriate windfall or shortfall years later.

Not just for the money

At any point in time, director compensation is not likely to be fully commensurate with the increasing demands of board service. Compensation is only one part of the equation. We need to consider both extrinsic and intrinsic motivations. Intrinsic motivation is non- monetary rewards, such as networking opportunities, building relationships with like-minded peers, engaging in interesting work, and contributing to the business community. Individual directors generally tend to be circumspect about their compensation and are not in it "just for the money".

How does a company attract quality directors in an environment where there is intense competition and potential risks to one's reputation? Just like any talent competition, information flow, transparency and disclosure would help to maintain an efficient functioning of the marketplace. The dynamics between market supply and demand should place the right talent at the right place, and result in fair payment, not underpayment or overpayment.

Proxy advisers since 2019 have started scrutinising director compensation beyond just CEO compensation. ISS Analytics uses a methodology in the US to identify the top 2 per cent outliers among peer directors in the same industry grouping. Its guideline for Singapore is practical for a small market: compare director compensation relative to fees paid by other companies of similar sizes to determine if the level is excessive.

Having an independent and rigorous process to benchmark director compensation would set a company off on the right path to win the confidence of the shareholders and the larger community. The policy should articulate sound principles and rationale for the decisions taken and disclosed in a transparent manner. And this should apply collectively to the board and individual directors' contributions and compensation.

In recent years, shareholder primacy has enlarged to a wider set of stakeholders. In the future, when there is a commonly adopted set of quantitative ESG measures that could be subject to external assurance, we should be able to include these measures as stakeholder value creation adding to shareholder value. Meanwhile, it is important to actively engage with key stakeholders to communicate strategic intent and progress, mitigate risks, and align expectations. ■

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