Higher fees may not translate to directors of higher quality

By MAK YUEN TEN

OUR report headlined “Boardroom income disparity widening: survey” (BT, July 13) on the recently released survey by the Singapore Institute of Directors (SID) raises one of which is the relative pay of executive and non-executive directors.

We need to be careful when comparing the pay of executive and non-executive directors as their roles are very different, and one is a full-time role while the other is not.

I also wonder whether the reported amounts earned by non-executive directors included the value of share options or other share grants. As I wrote in a commentary recently, most companies which use share-based incentives for non-executive directors do not include the fair value of such incentives as part of the total directors’ fees put up for shareholders’ approval. Therefore, it is possible that the non-executive directors’ pay reported by respondents was understated.

The so-called widening boardroom income disparity is probably just part of the widening disparity between senior executive pay and (almost) everybody else’s pay – including the pay of the average employee and university professor.

While I fully agree that non-executive directors should be paid fees commensurate with their expertise, responsibilities, time commitments and contributions, some non-executive directors who sit on many boards and attend meetings ill-prepared and who scampers from meeting to meeting are already getting more than they deserve. Consider some independent directors who sit on more than 10 boards and draw, say, an average of $50,000 per board, including extra fees for attendance or for being chairs or members of committees. As they say, it’s not a bad gig if you can get it.

Further, directors here certainly face less risk of being charged by regulators or sued by shareholders (the Air-occas case notwithstanding) than those in other countries such as Australia. So the “risk premium” for being a director here should be lower. While paying peanuts may get you a monkey, paying too much may get you a Yogi bear: someone nice and cuddly towards management and the controlling shareholders but reluctant to ask questions and even more reluctant to retire.

Any adjustment to non-executive directors’ pay must go hand in hand with sufficient safeguards with respect to the independence and quality of directors, and ensuring that the directors devote sufficient attention to the companies. A good director will never do it just for the money, but a bad director certainly will. Therefore, increased pay without other safeguards may enrich the bad directors while not necessarily encourage more good people to serve on boards.

We should also remember that, at the moment, just about anyone can be a director if they have the right connections, and there are no mandatory training and continuing education requirements. With the wide disparity in quality and commitment of non-executive directors at the moment and little substantive progress in improving this, it is a little difficult to empathise with concerns about low fees.

In my view, some non-executive directors deserve more than they are being paid – and some are already overpaid for the little contribution they are making or the pain and suffering they are causing minority shareholders.

While the scrutiny of non-executive directors’ fees seems disproportionate compared to the scrutiny of executive pay because of their relative amounts, it is important to point out that there is a stronger conflict of interest when it comes to non-executive directors’ fees, which explains why they should continue to be scrutinised and approved by shareholders.

Otherwise, what you will have is a remuneration committee recommending fees for non-executive directors – including the members of the committee themselves – and the board (including the executive directors) approving the non-executive directors’ fees, as is actually the case in the US.

This will make the entire process too incestuous and may even further reinforce the risk that the non-executive and executive directors will try to ratchet up each other’s pay. Shareholders’ approval of non-executive directors’ pay, while imperfect because of insufficient knowledge about what is reasonable pay, is still a good check and balance to have.

As a first principle, executive pay ought to be a matter for the board to decide, just as it is for the board to appoint the CEO. The fact that we now have shareholders creeping into the boardroom through non-binding votes for executive pay in a growing number of countries reflects the widespread dissatisfaction of shareholders and regulators about the job that boards are doing in this area. In many of these jurisdictions, there is a justified view that many boards are captured by their CEOs.

This is not to say that we should not be concerned about escalating levels of senior executive pay in Singapore. However, here, our major problem is that the board is often captured by controlling shareholders (who, of course, could also be senior executives or related to them). This leads me to the finding in the SID survey that 97 per cent of companies identified potential non-executive directors through personal contacts.

Given this, how can minority shareholders trust that the independent directors will truly be independent and will really look after the interests of all shareholders, and that they will have the necessary competencies? To expect many of these directors recruited through such means to objectively make all kinds of decisions – including determining the independence of their fellow directors – is wishful thinking.

The more important issue for us to address is the independence and quality of boards. Rather than a “say on pay”, how about a “say on independence” by disinterested shareholders?

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