

Best practices when paying Non-Executive Directors' fees

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Deciding what to pay Non-Executive Directors is not an easy task. The Executive Management and remuneration committee members need to be careful when recommending NEDs fees. The likely impact of paying your Non-Executive Directors below general market practices is that they will rarely commit themselves to the business of the organisation. The dilemma is that if you pay way too much above market practices, it is likely to be viewed by other key stakeholders as self-enrichment and may attract unnecessary negative publicity. Employees and other stakeholders tend to view above-market Director's fees as greediness.

What is a Non-Executive director?

A Non-Executive Director is a member of a company's board of directors who is not part of the executive team. Non-Executive Directors are typically not involved in the day-to-day management of the organisation but are involved in policymaking and strategic leadership. Non-Executive Directors' responsibilities include monitoring of the executive directors and acting in the interest of the company when making decisions. Non-executive directors carry significant potential risk and liability. This requires special skills, knowledge, experience and business focus, for which they need to be remunerated fairly.

Determining Non-Executive Directors' fees

Determining what you should pay your Non-Executive Director is not easy. A number of factors will need to be evaluated first when determining what to pay your Non-Executive Directors. Some of the factors are:

- The size of the organisation;
- The industry and complexity of the business;
- The number of meetings attended
- The time commitment required of the Non-Executive Director.

Best Practices in non-executive directors fees

- Non-Executive Directors' fees should correlate with company size. Larger companies should generally pay higher director fees. The median total annual director compensation of S&P 500 companies (approximately \$285,000) is 63% higher than the median total director pay for the rest of the Russell 3000. (ISS Analytics)
- Non-Executive Directors' fees should reflect in industries where specialised skills and expertise are required from *NEDs*. According to the ISS Analytics, among S&P 500 companies in US,

those in the pharmaceutical and biotechnology firms offer the highest non-executive director pay packages with a median pay figure of approximately \$347,000 per annum.

- Non-Executive Director pay levels should generally correlate with CEO pay since both figures are typically determined by the size and complexity of the company.
- Time commitments for Non-Executive Directors must correlate with revenue size.
- According to Pearl Meyer's Non-Employee Director Pay Practices survey, respondents in the \$3 billion or more category cited longest time commitments whilst respondents under \$500 million category recorded lowest.
- Approximately one-third of respondents in the Pearl Meyer's Non-Employee Director Pay Practices survey compensate for activities such as special committee meetings, and unusual events.
- Industry and company size are the most important factor to consider for NED compensation benchmarking. According to Pearl Meyer's Non-Employee Director Pay Practices survey, approximately half of respondents pay their Non-Executive Directors at the market 50th percentile while 25% target above the 50th percentile.
- Differentiation can be made in the fees paid to resident versus non-resident directors.

- Providing additional compensation for example meeting fees and per diems in situations where time requirements are significantly greater than normal is also an emerging trend.

In conclusion, companies should ensure their Non-Executive Directors' fees are sufficiently competitive to attract and retain highly qualified directors.

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