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Rightsize pay gap between executive and non-executive directors — ICDM

Institute's CEO says this disparity must be addressed to ensure a higher quality, independence of directors

BY TAN XUE YING

KUALA LUMPUR: The huge disparity between the remuneration of executive directors (EDs) and independent non-executive directors (NEDs) in corporate Malaysia must be addressed to ensure a higher quality and independence of directors, according to the Institute of Corporate Directors Malaysia (ICDM).

In light of recent corporate scandals in Malaysia, questions have been raised about whether corporates are attracting the right talent as independent directors, ICDM president cum chief executive officer Michele Kythe Lim said, noting adequate compensation plays a key role in such matters.

"All their responsibilities are the same under the Companies Act, but the pay is quite different. And we are trying to rightsize that imbalance," Lim, a trained lawyer, told reporters on the sidelines of its conference here yesterday.

"The reality is that EDs are paid quite well and without going through shareholders' approval, whereas independent or NEDs are not paid as much, but their fees get (have to be) approved by shareholders," she said, adding that there is a misconception that all directors are handsomely paid in corporate Malaysia.

The average pay per NED ranges from RM150,000 to RM200,000 per year, and could go up to RM300,000 to RM400,000 for larger companies, said Willis Towers Watson Malaysia ED and head of HR advisory Tan Juan Jim.

Willis Towers Watson managing director and global practice leader of executive compensation, Mark Reid highlighted that the "rightsizing" of the pay gap between EDs and non-EDs must be done with awareness that NED fees should be kept simple and non-performance-related to avoid any conflict of interest.

"Getting that balance right between 'enough to be appropriate, and not so much that independence is compromised,' is important," he stressed.

Reid said that in the past, there had been a lot of scrutiny of executive pay because of the eye-catching high numbers. He opined that equal attention must be paid to NED remuneration as NEDs have seen their roles evolving throughout the years and are now expected to shoulder more responsibilities than before.

Lim: The reality is that EDs are paid quite well and without going through shareholders' approval. Photo by Shahrin Yahya

"Data show that typical NEDs are spending around 30% more time now in their role than they did 10 or so years ago. The degree of external scrutiny has gone up. There is [a] lot more disclosure now on fee levels and decisions and therefore the risks to reputation of directors — legal and financial — too have increased with the increased number of lawsuits.

"So, on the one hand, there is a lot of pressure on NEDs to do more and take on more risks, which would naturally imply that fee levels should rise accordingly. But, on the other hand, there is a lot of societal pressure on equality, affordability and fairness," he said.

Another misconception is that NED roles are for retirees, when in fact their responsibilities are onerous and increasingly so, said the ICDM. This is as NEDs too have to comply with laws and regulations and keep up with the latest developments in corporate governance and how director duties are dispensed.

"The responsibility has always been there. It is not just a nice job to have when you are retiring, to attend board meetings and earn a fee and not have a huge responsibility," said Lim, adding that as attracting the right talent is becoming critical, the pay must be commensurate.

Too much fee disclosure 'not necessarily good'

According to the ICDM, too much fee disclosure may not necessarily be a good thing, as it may have unintended consequences.

"First, disclosure has driven pay inflation, rather than pay moderation, as it gives executives ready benchmarks to compare themselves. Secondly, it drives much greater individual scrutiny — which executives tend not to like — and reduces people's willingness to be on the board because it invades their privacy," said Reid.

"Also, as we have seen greater requirements of disclosure, not just of pay levels but pay design (as seen in the UK), it is requiring a level of granularity that is actually compromising confidentiality of strategy," he added.

Lim believes that stressing disclosure without a clear end goal may also discourage or disincentivise businesses — especially unlisted small- and medium-sized enterprises — from participating in the equity market.

There are a total of 8,000 EDs and NEDs among the 900-plus public listed companies, according to the ICDM, which was set up in October 2018 to enhance professionalism and effectiveness of corporate directors in the country.

The Malaysian Code on Corporate Governance 2017 stipulates that half of the board members of listed companies should comprise independent directors.