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A communiqué on corporate governance

September 2013.

Academy of Corporate Governance

(A registered public trust operating since 2001)

Article:

Director Compensation – A perspective on the dynamics

In a dip-stick estimate we did, over 80% directors believed they were underpaid. Most of these were from the SOE, mid-caps and loss-making firms. Some of them expressed that paying peanuts gets their companies monkeys – little realising that they were describing themselves indirectly! It is difficult to justify an existing compensation or quarrel with it as the broad managerial principles of internal and external equity and scientifically structured variable pay cannot be applied well in the case of directors.

Unlike managers who come as one class (even if in different grades) with a similar type of employment contract, directors are a portfolio. They may be a bunch of non-executive directors (NEDs) representing the financial institutions, promoters or strategic equity holders; whole time directors; NEDs representing special interest groups either in compliance with law, or by convention; or independent directors. Each is a type that is not comparable with the rest.

To the NEDs representing financial institutions, often directorship is less material than their contracts of employment, thus making director compensation inconsequential (except in curious cases such as those of L&T and the LIC nominees' issue). In any case, most such institutions insist on direct payment to the firm or have their nominees decline compensation. This aggravates the loyalty issue. Though the principle of corporate governance states that directors owe their first duty to the company, in practice they bear upper-most in mind, the interests of their constituency or individuals who put them there. No wonder that representatives of institutional investors and PE firms would be more attentive to valuations of their stock and exit strategies than the long-term interests of the investee company.

A similar situation applies to full-time directors who have employment contracts with the company. The pay, including bonus and incentives, is related to their performance as executives and not as directors. In the process, most working directors do not make a distinction between their

duties and responsibilities as directors and their role as executives. This makes the full-time director full of management and little of board!

In the case of NEDs representing promoters, it is assumed that their performance will be guided by enlightened self-interest, of increasing shareholder wealth. Contrarily, there is a pronounced distortion in the motivational pact of the directors representing special interest groups such as trade unions, small investors or borrowers. While the principle of corporate governance exhorts them to think of the company first, the very motivation behind sectional or special representation is to protect the interest of the constituency.

Thus, eventually, it is left to the independent directors to balance the diversities and bring forth board independence and show care and loyalty. A tough call especially given their limited numbers and quality in the context of emerging market economies. Even if their selection and appointments were objective and meritorious, their diversity in background and market worth creates distortions in internal and external equity. While some may be high profile industry leaders, others may be from NGOs or academia. The market worth of such directors would be different from one another. Yet, the compensation — in the form of sitting fee, commission on profits, director fee, (or stock grants in countries that permit them for such class) — is invariably the same.

The unstated principle appears to be “same class same pay”. Despite much noise on evaluation, pay does not vary with performance. Variance in pay is only in sitting fee, where applicable, as it is linked to attendance. Commission on profits, which many consider as free-riding, does not differentiate between one’s single meeting from another’s eight in the year.

One potential reason for not varying director remuneration amongst the independent directors is the fear of differential liability commensurate with differential fee. Consequently, the international practice also is to make the fee common to all NEDs and compensate additionally the independent Chair or Chairs of committees and other committee work.

Because of this compulsion for parity, some directors may end up getting paid more than their worth in terms of their market value or contribution in the board. If an independent director is overpaid, the conditions would be right for not only non-performance but even collusion. Thus, the popular managerial principles of internal equity, external equity as well as pay for truly measured performance get undermined in many ways.

In the end, peanuts or pots, a company may get the animal the controlling system wants. As for the intending director or those crying for more, they must realise that Directorship is somewhat like cows grazing. One has to be on the right spot to graze well — such grazing has little to do with one’s size or the amount of milk one can produce!

(Adapted from a previously published Column by Y.R.K.Reddy, in Financial Express, India, titled: Director Pay: In Search of Rationale)

TITBIT

Academy of Corporate Governance has applied, at the request of SADC-DFRC Botswana, for accreditation of the GCGF-DFRC Training Program on Corporate Governance, which was authored and facilitated by the Founder & President since 2007.

Founder & President has been invited by the OECDs BIAC for a High-level Business Meeting with the OECD for review / update of the Principles on Corporate Governance. Meeting is scheduled for 12th November, 2013.

Extracts from: SADC-DFRC Newsletter, Issue6, June 2013.

Training on Corporate Governance – Director Skills: 23rd - 26th April 2013

The SADC Development Finance Resource Centre in collaboration with the African Development Institute (ADI) of the African Development Bank (ADB) held a training programme on Corporate Governance – Director Skill in Windhoek, Namibia.

The purpose of the programme was to raise awareness of the concept, practice and relevance of good corporate governance in the context of development finance institutions and the challenges they face within

the African landscape. The programme also provided the opportunity for serving directors and board members to improve their skills in the boardroom through a practical and interactive approach that involved case studies, group work and discussions, as well as the prospect of sharing experiences with directors on boards of development finance institutions from African countries. The workshop was facilitated by Professor YRK Reddy, an international corporate governance consultant.

The programme was attended by 26 participants from 22 Development Finance Institutions and 9 countries across the SADC region. Countries represented were Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania and Zimbabwe. Prof. YRK Reddy of Academy of Corporate Governance in Hyderabad, India and Mr Edward Kabwe, Corporate Governance and financial consultant from Zambia resourced the programme.



[L to R]: Prof Y.R.K Reddy (ACG), Dr. Lassaad Lachaal (ADI), Mr. Martin Inkumbi (DBN), Mr. Julius Mukoji (TIB) and Mr. Stuart Kufeni (SADC-DFRC) during the closing ceremony.



Participants at the Corporate Governance – Director Skills, Windhoek Country Club Hotel

Mr. Stuart Kufeni, Chief Executive Officer, SADC - DFRC welcomed the delegates, and Dr. Lassaad Lachaal, the Chief Training Economist at the African Development Institute (ADI) officially opened the workshop. Mr. Martin Inkumbi, acting Chief Executive Officer for the Development Bank of Namibia officially closed the workshop and presented certificates. Mr. Inkumbi applauded the two institutions (DFRC and ADI) for a job well done and encouraged delegates to use the knowledge they have acquired from the training as soon as they are back in their offices to benefit their institutions.

PHOTO GALLERY- RECENT MONTHS



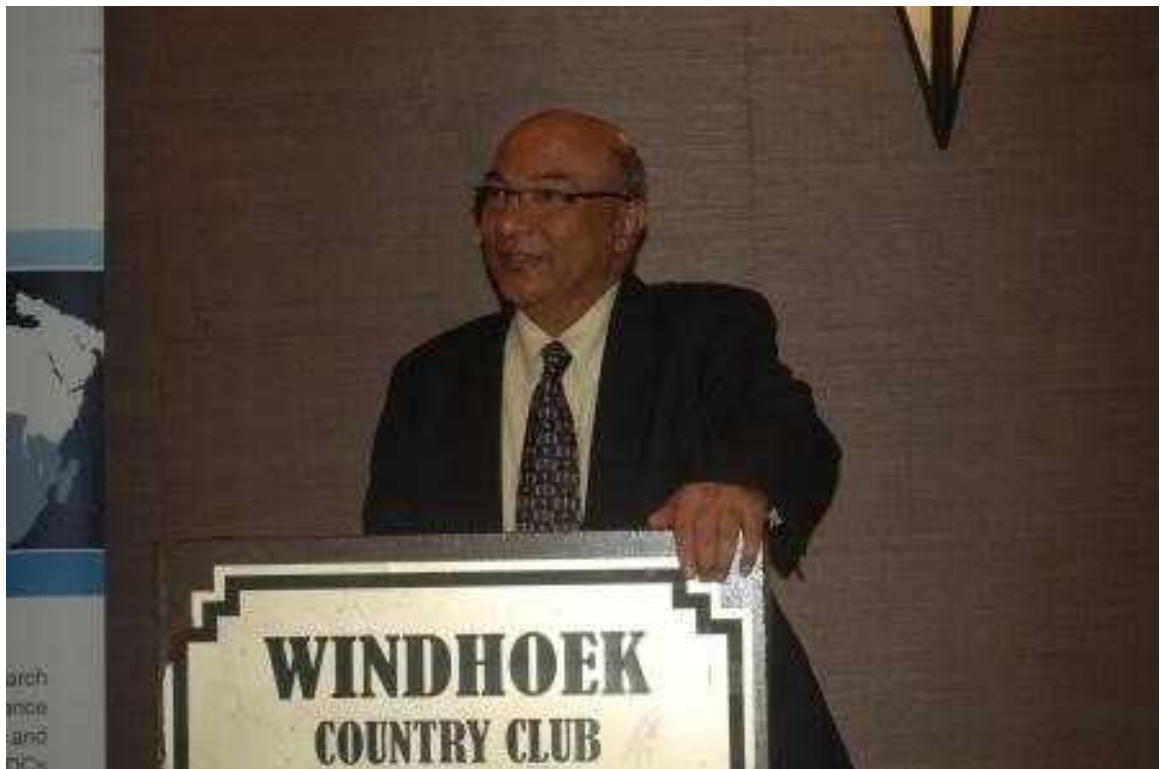
Inaugural Session of the ACG-SCOPE's X Programme on Corporate Governance.
Left to Right: Dr.U.B.Choubey, DG, SCOPE; Mr.Rawat, Secretary, DPE,
Government of India; Dr. Y.R.K Reddy & Ms.Angela Gillibrand – Resource Persons;
Mr.Pavadia, Joint Secretary, DPE.



Dr.Y.R.K.Reddy at the CEO Colloquium of SADC-DFRC DFI Network as Advisor
and Facilitator -. 14th – 15th March 2013, Johannesburg.



Dr.Y.R.K.Reddy addressing the CEO Colloquium of SADC-DFRC DFI Network as Advisor and Facilitator -. 14th – 15th March 2013, Johannesburg,



Dr.Y.R.K.Reddy, lead facilitator, at the Corporate Governance Programme of DFRC conducted with the support of African Development Institute, AfDB,23- 26 April, 2013 at Windhoek, Namibia.



Y.R.K.Reddy, lead facilitator, Lassaad Lachaal, African Development Institute, and Martin Inkumbi, DBN at the Corporate Governance Programme of 23- 26, April, 2013 at Windhoek, Namibia

RETROSPECTIVE - 2012.

1. Address at the Visakhapatnam Chapter of Computer society of India, by founder trustee on *Corporate Governance & ICT - the Synergetic Linkages* January 6th 2012.
2. Address at the first South India Conference of the India Development Coalition of America by Founder Trustee on *Excellence in NGO Governance – Building Support Networks* February 3rd 2012.
3. Address at the Federation of Andhra Pradesh Chamber of Commerce & Industry by founder trustee on *Stakeholder Engagement – Dynamics and Strategies*, February 9th 2012.
4. Address at the 2012 *International Meet of Corporate Registers Forum* hosted by the Ministry of Corporate Affairs in association with ICSI at New Delhi by founder trustee, February 13th to 17th 2012.
5. Address to the Board & Senior Management on *Corporate Governance* by founder trustee at Rashtriya Ispath Nigam Limited, Visakhapatnam, 7th April 2012.
6. Revisions to the GCGF-DFRC training pack were carried out by founder trustee, on an interim basis on commission by DFRC, as version 2.5.
7. Assistance by founder trustee to the Committee of ICSIs to *review the methodology* for corporate governance excellence awards.

8. ACG–SCOPE’s *IX Programme on Corporate Governance for CEOs and Directors*, with Founder Trustee and Ms. Anne Molyneux as lead facilitators, at Lalit Ashok, Bangalore, April 27th – 28th 2012.

9. Facilitation for GFA consulting – Germany, (a EU Commission’s agency) by founder trustee, in implementing *a Training programme and Workshop on Corporate Governance with specific reference to SME sector*, Pretoria, May 29th to June 7th 2012.

10. Facilitation by founder trustee in the African Development Bank funded programme of *SADC-DFRC on Corporate Governance for Directors*, Cape Town, July 9th to 12th 2012.

11. Address by founder trustee at the Corporate Governance Conference of the *Hong Kong Institute of Chartered Secretaries*, Hong Kong, October 5th & 6th 2012.

12. Article titled “Board Structure – The Case for Diversity” at the request of the *Corporate Governance Journal, Hong Kong* Oct, 2012.

13. Article titled “*Boards - The reality of co-existing diverse models*”, *Boardroom, the Magazine for Chartered Secretaries, South Africa* Quarter 4, 2012.