

Rethinking Nomination and Remuneration

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MICG Seminar on Directors' Remuneration,

Hotel Istana, February 28th 2013

Agenda

1. **Nomination Issues:**

- a. Creating the right board balance:
- b. Reconciling stakeholder interests
- c. Reconciling professions and personalities
- d. Managing diversity to minimize groupthink
- e. Reconciling past achievements with future need

2. **Remuneration: CORTEX**

- a. Complexity of the role
- b. Opportunity cost of the director's time
- c. Role and responsibilities
- d. Time needed to fulfil the role
- e. Experience needed to do the job
- f. X factor

Nomination

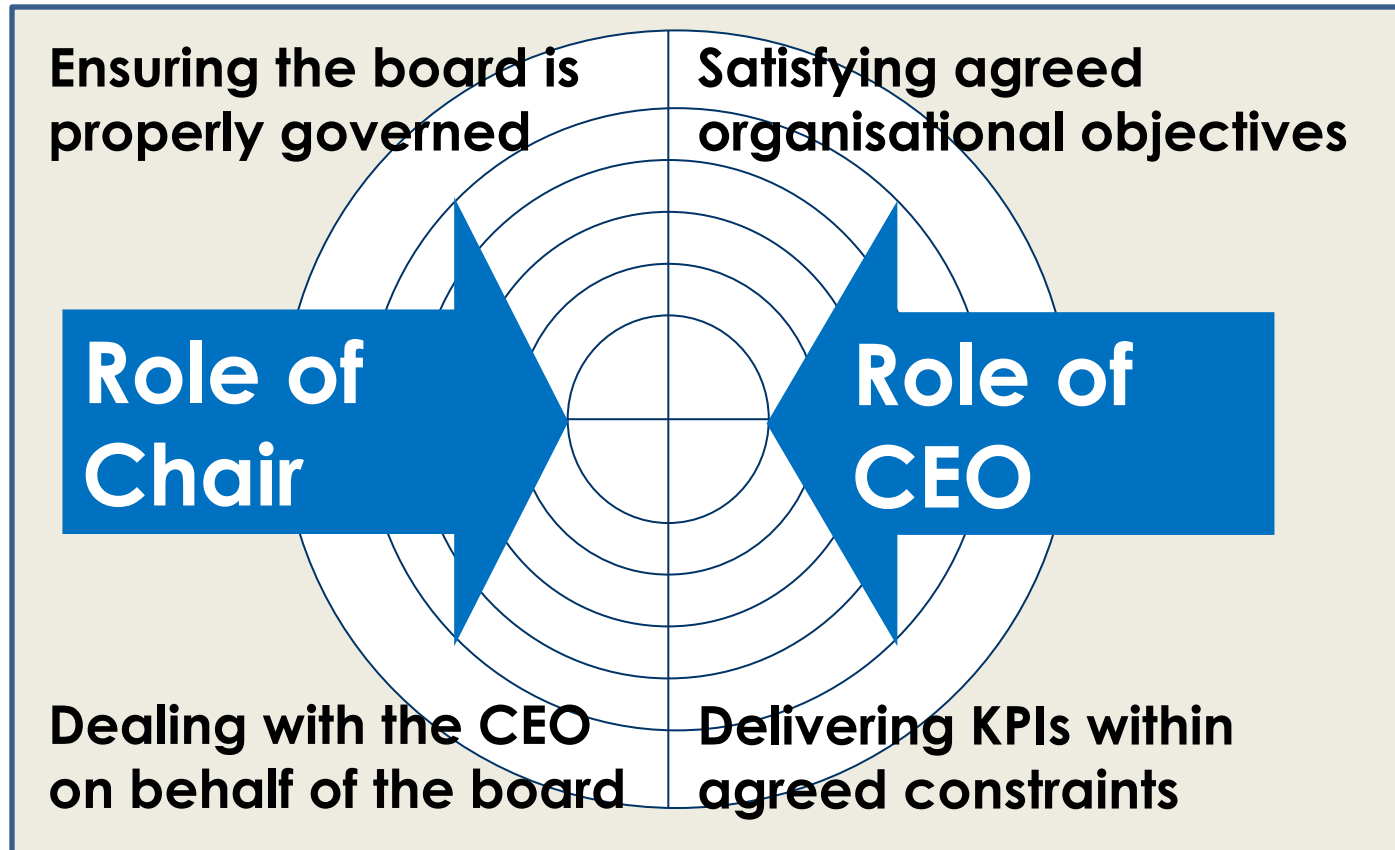
Creating the Right Board Balance

1. Separation of Chair and CEO (Rec. 3.4)
2. Chair should be non-executive (Rec. 3.4)
3. Majority INEDs, when the Chair is not an INED (Rec. 3.5)
4. INED should not have more than nine years tenure, but may serve longer as a NINED (Rec. 3.2) if
 - a. In the company's interests
 - b. Agreed to by the shareholders
5. Recruit women INEDs and show how the gender diversity targets are being met (Rec. 2.2)

Separation of Chair and CEO

“The separation of the roles between the chairman and CEO will allow them to focus on their respective responsibilities.”

Corporate Governance Blueprint 2011, p32



Nomination

Reconciling stakeholder interests

Family firm:

The overall aim of our company is shared family wealth and work.

The family stays together with appropriate, satisfying, and rewarding work for every adult member who chooses to be in the company

PLC:

The overall aim of the company is return on equity better than the return for firms of similar risk characteristics.

GLC:

The overall aim of our company is improved national wealth and work. Society stays united with appropriate, satisfying, and rewarding work for every adult member who chooses to be in the company, which has an obligation to the community as a whole.

Nomination

Reconciling Professions and Personalities

Situation:

To maximize the INED input, Boards need:

1. **Mix of backgrounds:**

- Lawyer?
- Accountant?
- Civil Servant?
- Diplomat?
- Banker?
- Risk specialist?
- Industry experts?
- 30% Women?

2. **The right personal chemistry** to deal with:

- Outside Stakeholders?
- Family?
- Government?
- Fellow directors

Complication:

1. The optimum size for an effective board is 7-11 members.
2. Yet to have all the right mix may mean having very large boards.
3. They are either dysfunctional or rely on using ExcOs, which in turn disenfranchise the other directors.
4. Relevant board experience is perishable.
5. Chemistry matters.

Resolution:

1. NC must get the right mix of evergreen technical expertise, selecting the right professions to sit on the board, supplemented by the best advisers.
2. NC must know how they will interact with key stakeholders and each other.
3. NC must assess their adherence to Values and ethics.
4. NC cannot just look at CVs.

Nomination

Managing diversity to minimize groupthink

"Aren't we great (and wrong)!"

One of the most famous phenomena in social psychology is groupthink, the tendency of a group to converge on a consensus without much critical evaluation, even if the consensus is wrong...

... The students were given 20 minutes to read a murder mystery and deduce the most likely perpetrator out of three suspects. Individually, only 44 percent of the students got it right, which is slightly better than chance.

The students were then sorted into groups of three, all from the same fraternity or sorority, and were given 20 minutes to come to agreement on the most likely suspect. After a few minutes, a fourth member was added to the group - sometimes from the same fraternity or sorority, sometimes from a different one.

If the new member came from a different fraternity or sorority, the group performed objectively better than the totally homogeneous groups (75 percent vs. 54 percent correct), and members with incorrect guesses were much more likely to change their minds. Nevertheless, the homogeneous groups perceived themselves as having more confidence, consensus, and effective interaction."

Phillips, K. et al., "Is the Pain Worth the Gain? The Advantages and Liabilities of Agreeing With Socially Distinct Newcomers," Personality and Social Psychology Bulletin (forthcoming).

Nomination

Managing diversity to minimize groupthink

“I am not a feminist. I am a conservative. I am practical, rational and I want Norway to flourish. ***This is about shareholders rights.***

This change gives shareholders more choice about a key element in value creation in a company, diversity. Diversity is a value in itself that creates wealth.

It's important that boards have diversity in education, experience, expertise, age, gender, etc.

Too many boards have 7, 9, 11 people who are made in the same factory, very often with the same education, very often in the same year. They go sailing, boar hunting and fishing together. They dine in the same restaurant. They are very alike.

I believe in the opposite. ***It is important that people think their own, different thoughts, and get to say what is needed, not what is wanted.***”

Ansgar Gabrielson, Norway's Minister of Trade, 2001

Nomination

Managing diversity to create greater value

Companies with gender balance at the top do better:

- **ROE:**

Companies with at least 25% women in their senior leadership team make 35% higher ROE *(Catalyst Research)*

- **Ranking:**

Companies with at least 25% women in senior leadership team are consistently in the top quartile of their peer group *(McKinsey)*

- **Innovation and Effectiveness:**

Teams that are exactly 50/50 male/female achieve substantially higher results in terms of both innovation and effectiveness *(London Business School)*

- **Earnings:**

From 2000 to 2009, women-managed hedge funds earned an average of 9% while a composite HFR index averaged only 6%.

During the downturn of 2008, while the HFR composite dropped 19%, funds managed by women declined on average by less than 10%. *(Hedge Fund Research, Inc.)*

Nomination

Diversity makes a difference to beliefs...

No.	Cultural Dimensions	Malays	Indians	Chinese	Scots
1.	Harmony	3	0	3	0
2.	Control/Mastery	0	2	3	3
3.	Relationships	3	3	3	1
4.	Task	0	0	0	3
5.	Hierarchy	3	3	2	0
6.	Equality	0	1	0	3
7.	Shame	3	3	3	2
8.	Guilt	0	1	1	3
9.	High Context	3	2	0	0
10.	Low Context	0	3	1	3
11.	Polychronic time	1	2	3	1
12.	Monochronic	2	1	1	2
13.	We –Collectivism	3	1	1	1
14.	Individualism	0	3	2	3
15.	Religious	3	0	0	0
16.	Secular	1	2	2	2

Scoring: 0 = Not Observed; 1= Likely; 2: More likely; 3: Most likely

Source: Asma Abdullah

Nomination

...So does Education/Exposure

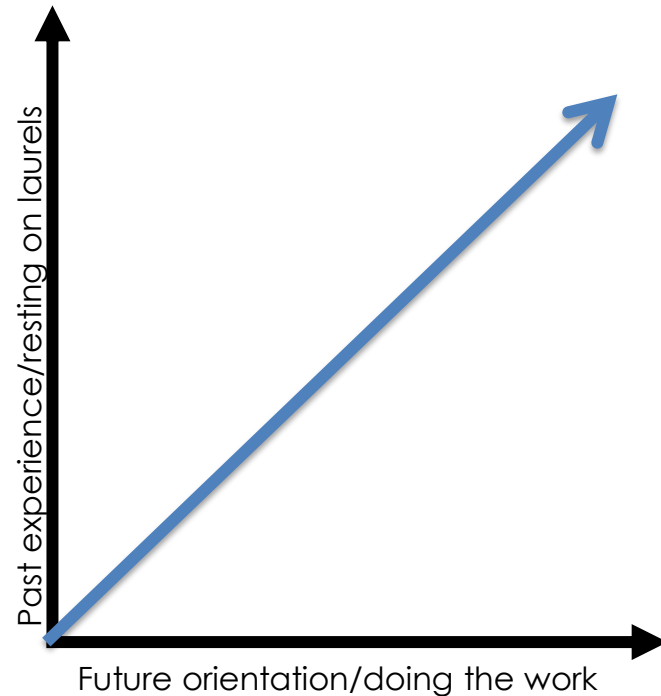
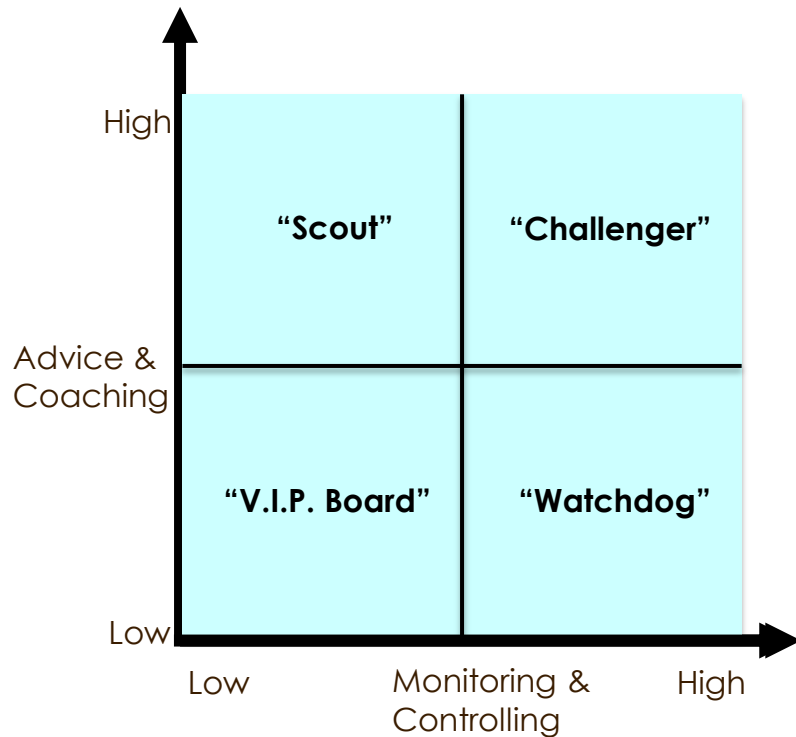
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Source: Asma Abdullah

Nomination

Reconciling past achievements with future need



Source: Steger, U., and Amann, W., (2008) *Corporate Governance: How to Add Value*. (John Wiley & Sons), p22

Remuneration: CORTEX

Complexity

1. Understands the macroeconomic drivers of value
2. Understands the microeconomic drivers of value
 - a. Where to compete
 - b. How to compete
3. Able to reconcile specialist, technical knowledge with generalist ability to “connect the dots”
4. Able to see the “big picture”, but dive into the numbers when needed
5. Appreciate the sources of risk
 - a. Systemic
 - b. Strategic
 - c. Business
 - d. Operational
 - e. Reputation
 - f. CEO and succession

Remuneration: CORTEX

Opportunity Cost

D. Remuneration levels and structure

Levels (opportunity cost)

- Current practice is to use benchmarking of absolute amounts as a basis for setting Director remuneration
- Inequity results once time commitment (need to compare 'per day' rates) and opportunity cost (need to consider professional 'per day' rates) is considered
- 83% of all Directors felt that increasing remuneration will make a difference in increasing the talent pool

Professionals

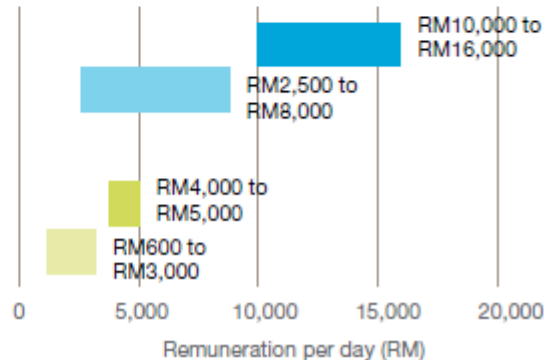
Gross range

Range after discounting

Directors

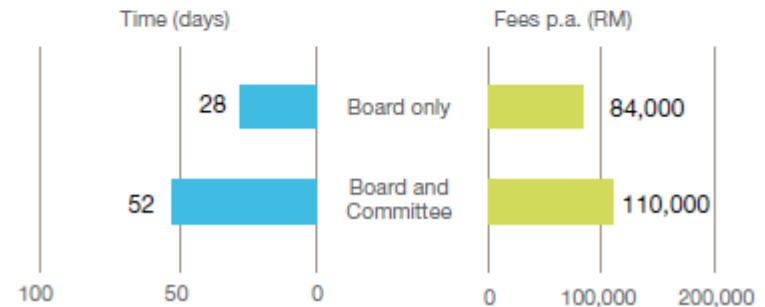
Competitive range

Current range



Structure mechanism

- Committee fees are typically only a fraction of the Board fees. As a result, typical Directors who sit on both Board and Committee receive lower remuneration of RM2,000 per day compared to RM3,000 per day for Directors who sit on Board only
- Time spent by Directors on Committee meetings can increase considerably by two to three times compared to their counterparts who sit on the Board only
- Remuneration on a Group basis needs to consider multiple responsibilities of Directors and the accompanying risks



from *Performance Pays*

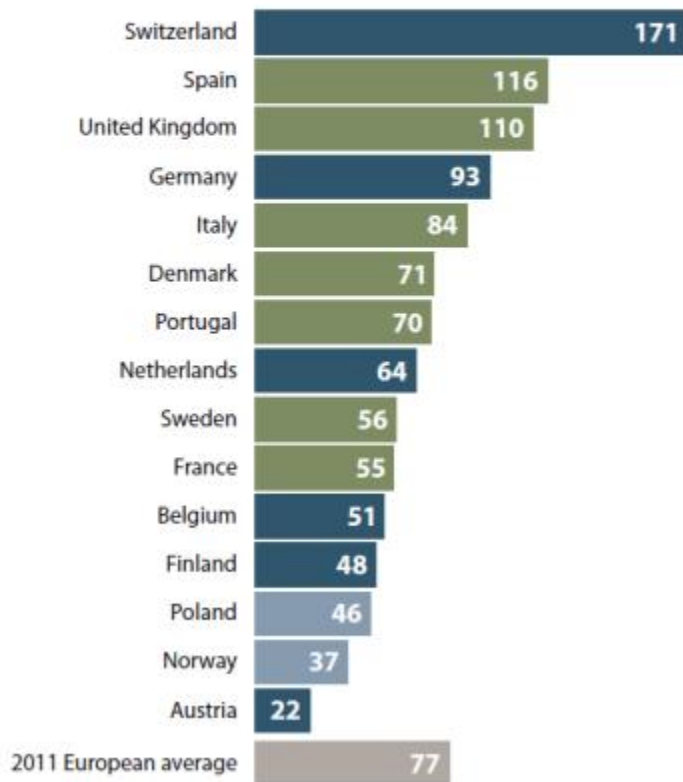
Remuneration: CORTEX

Roles and responsibilities

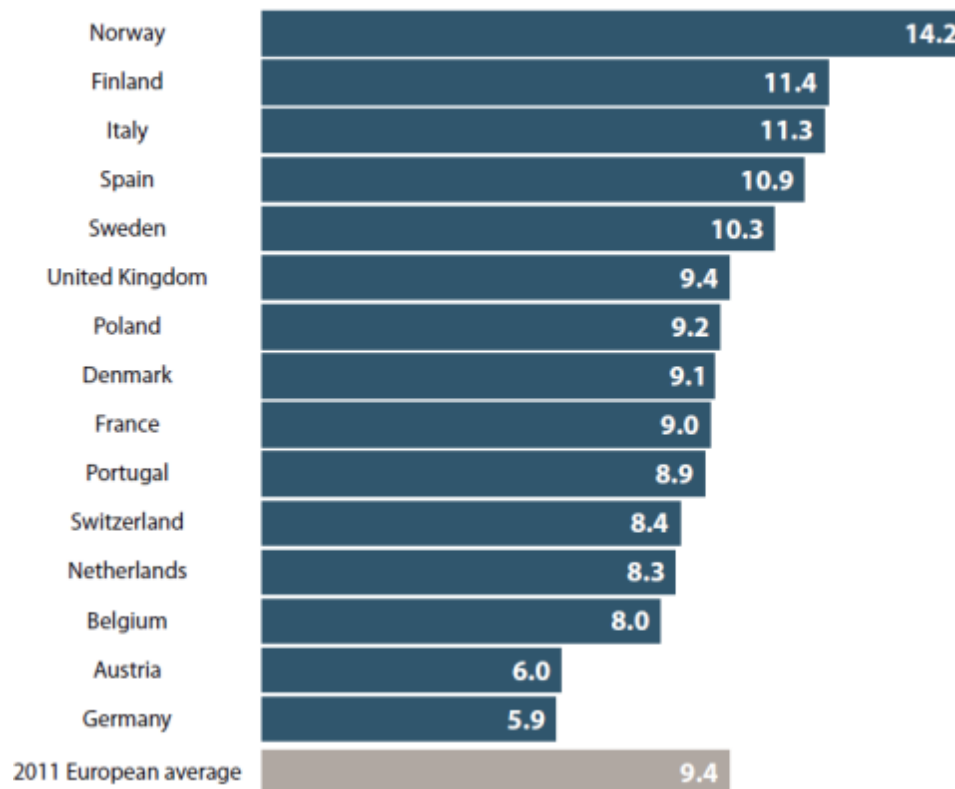
Average director remuneration

(in €1000)

- lower remuneration than in 2009
- stable or higher remuneration than in 2009
- no previous data



number of full board meetings per year



Source: Heidrick & Struggles. *European Corporate Governance Report 2011*

Remuneration: CORTEX

Experience

1. How to value company specific experience versus other experience?
2. How to value local versus global experience?
3. How to balance between specialists and generalists?
4. How to balance between professions and personalities?
5. What business experience?
 - a. Functions: HR, Finance, Marketing, Engineering, Operations, Communications, Law, Accounting?
 - b. Technical skills: finance, asset valuation, risk assessment, IT, planning, real estate, M&A, government relations, public policy?
 - c. Levels of seniority?
6. What experience of public life?
 - a. Civil service?
 - b. Military?
 - c. Diplomatic corps?
7. Age?

Remuneration: CORTEX

X Factor

1. Personal integrity
2. Courage to speak truth to power
3. Ability to challenge constructively, independent
4. Ability to build on other people's contribution
5. Open-minded and empathetic
6. Curious and willing to learn
7. Passionate about the industry and the organization
8. Excellent fiduciary:
 - a. Committed
 - b. Caring
 - c. Loyal

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Thank You