MINORITY SHAREHOLDERS WATCH GROUP
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ESOS, SHARE GRANTS

DON'T OVERPAY DIRECTORS

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PARAGRAPH 6.06 of the Bursa Malaysia Listing Requirements (LR) allows the allotment of shares to directors.

Often, public-listed companies (PLCs) may extend the issuance of shares in the form of employee share option scheme (Esos) and share grants to independent non-executive directors.

But this may not be a good idea from the corporate governance perspective.

First and foremost, an independent director is defined as a director who is independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interests of a company.

Thus, when PLCs grant shares to independent non-executive directors, there is a risk that the directors may be fixated or motivated by share price movements as opposed to acting in the best interest of the company.

This can be a real issue as most the directors on the audit committee are independent non-executive directors. And we all know that the audit committee is the first stop prior to the release of quarterly announcements and audited financial statements.

The last thing we want is for these independent non-executive directors to think about share price impact when discussing a huge impairment or write-off with the external auditors. And we all understand that impairments and write-offs hit the bottom line directly and that the bottom line has a strong correlation with share price.

The issue is exacerbated if future allocations of shares to independent non-executive directors are also based on bottom-line performance. Besides, the acronym Esos refers to "employees" which include executive directors.

Certainly, independent non-executive directors cannot come under the mantle of employees. The rationale for giving Esos to employees is to align their interests with that of shareholders but to offer the same alignment to independent non-executive directors may have undesired consequences — they may lose their ability to be independent and objective in their decision-making — without any consideration of share price allocations to them or share price movements.

There is a difference between acting in the best interest of shareholders (by aligning with the shareholders' interest) and acting in the best interest of the company. The fiduciary duty of directors is to act in the best interest of the company.

> *Somewhere in between, lies the fair remuneration for an independent non-executive director. This remuneration should take into consideration what the independent non-executive director brings to the board.*

Fixed remuneration for non-executive directors

Paragraph 7.23 of LR states that fees payable to non-executive directors shall be by a fixed sum, and not by a commission on or percentage of profits or turnover.

What is clear from this is that non-executive directors, including independent non-executive directors, should have fixed remuneration, i.e. a fixed sum, and that no part of the remuneration should relate to profits or turnover.

But by granting shares to them, this requirement is circumvented. Firstly, the quantum of shares granted to independent directors may be determined by the financial performance of the company — the more profitable the company, the greater the number of shares granted.

Secondly, the share price accretion enjoyed also have a direct correlation with the profit of the company. The higher the profits, the better the share price, and the better independent non-executive directors are remunerated.

So, in a roundabout way, the independent directors are being remunerated indirectly by profit movements. This may be seen as running contrary to the intentions of the stated rule in the listing requirements.

Fair remuneration for independent non-executive directors

Quality products come at a price, so do quality services. Better independent directors can and should attract better remuneration. Quality independent non-executive directors should be remunerated fairly but not through Esos or share grants.

The only caveat when remunerating independent non-executive directors is that if you overpay them, it would be difficult for them to be independent.

The independent non-executive directors will become so dependent on the high remuneration that they will think twice if there is a risk that they may lose that high remuneration.

We all know what happens when we pay peanuts. We also know what can happen when we overpay independent non-executive directors. Somewhere in between, lies the fair remuneration for an independent non-executive director. This remuneration should take into consideration what the independent non-executive director brings to the board. This remuneration is also dependent on the financial health of the company.

It is difficult to come up with a figure as a fair remuneration as there are so many factors to be considered. But we all know instinctively when an independent non-executive director is overpaid.

Perhaps, it is good to do some peer review of how other independent non-executive directors within the same industry are remunerated. This could serve as a guide.

Overpaying directors is not in the best interest of the company.

The writer is chief executive officer of the Minority Shareholders Watch Group