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REDEFINING NED REMUNERATION IN HIGH GROWTH COMPANIES

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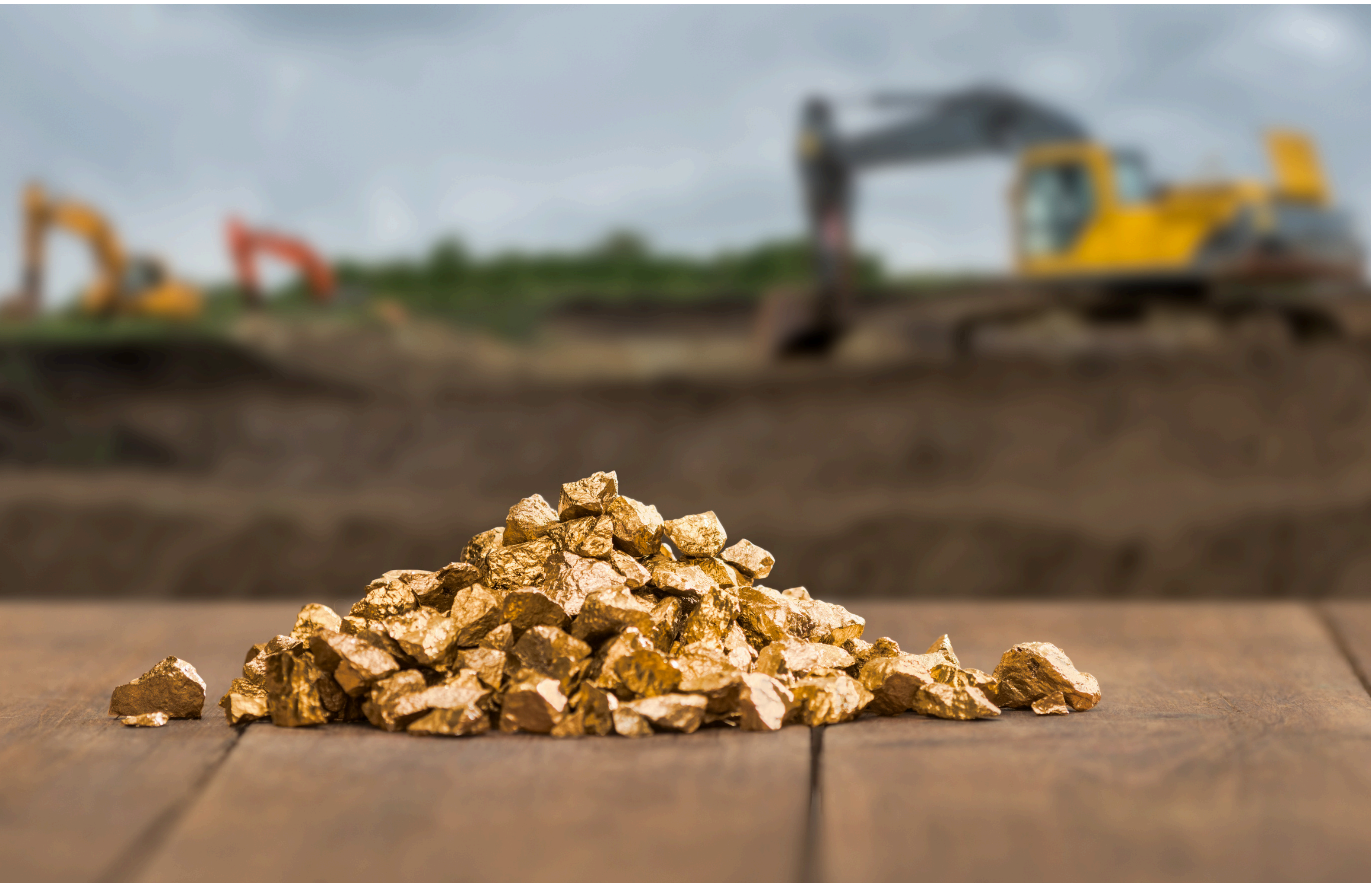
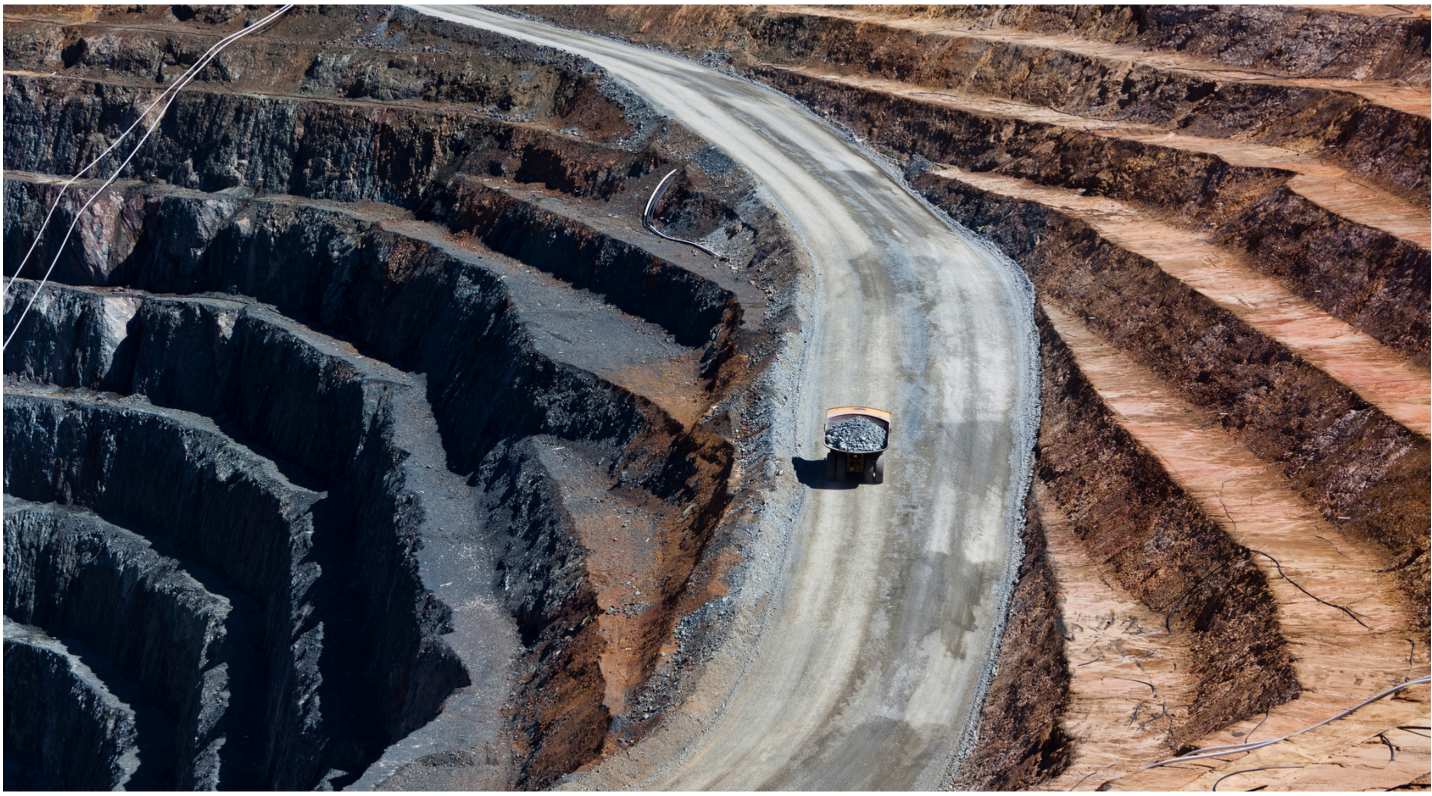


INTRODUCTION

In the rapidly evolving landscape of high-growth companies, the role of Non-Executive Directors (NEDs) is becoming increasingly pivotal. These individuals are tasked with guiding companies toward sustainable growth while navigating complex challenges that vary significantly across different market segments.

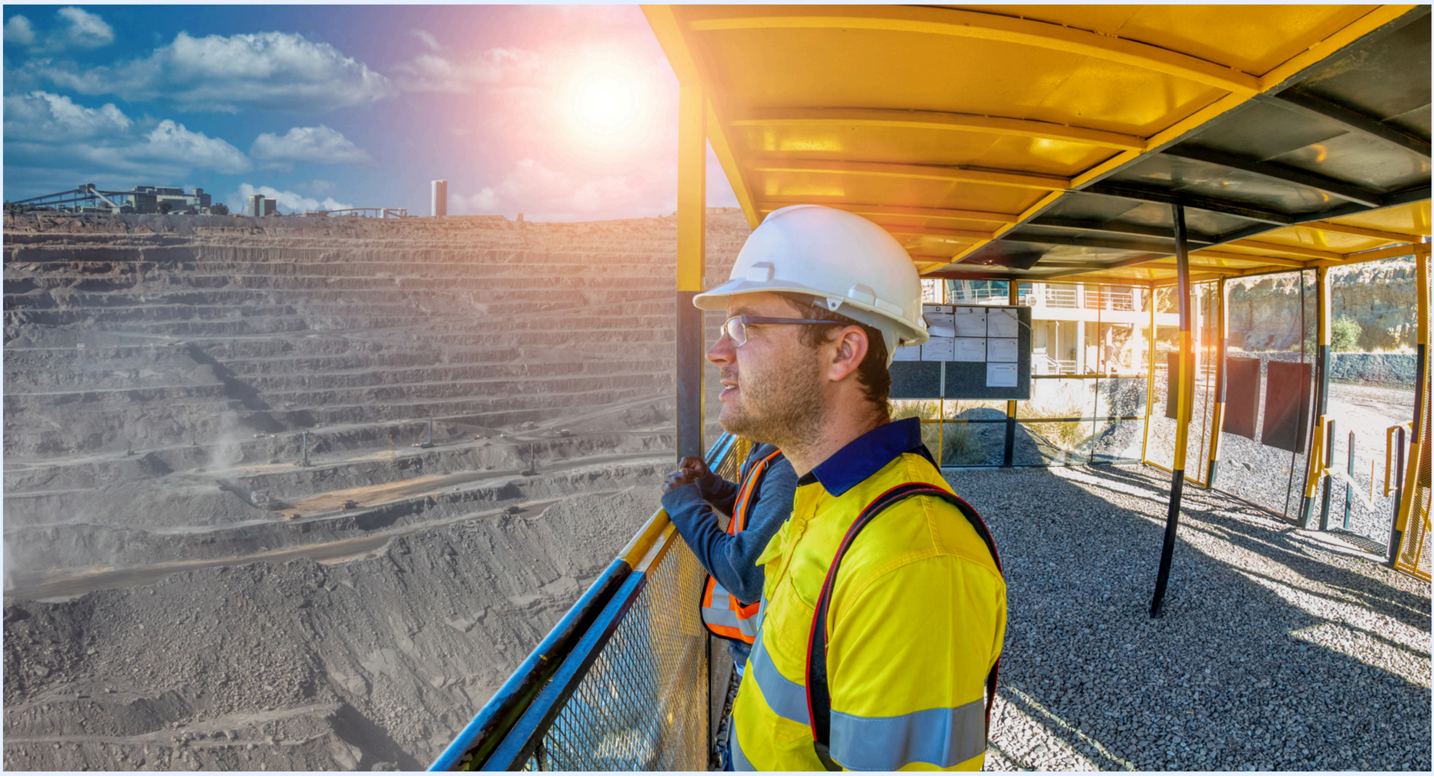
However, current remuneration models often fail to adequately reflect the demanding nature of these roles, particularly in terms of time commitment and associated risks. This article explores the intricacies of NED responsibilities within high-growth environments, assesses the shortcomings of existing remuneration structures, and proposes a governance-centric approach to better align NED incentives with long-term shareholder value.



Analyzing Time Commitments and Remuneration Benchmarking for NEDs

Shareholders are generally aware of market rates and the selection of peer companies used for remuneration benchmarking. However, what's not always evident is the significant time commitment that Non-Executive Directors (NEDs) invest in their roles. Annual reports often fail to provide adequate information regarding the actual time commitments of Non-Executive Directors (NEDs) in carrying out their duties.

Much of the time that NEDs devote to the companies they serve is not officially recorded, rendering fee calculations based on publicly available data insufficient and unreasonable. The link between the actual time NEDs invest in the company and the fees they receive is often tenuous. As a result, this discrepancy can lead to situations where NEDs are not fairly remunerated for their time and effort.



SHAREHOLDERS EXPECTATIONS OF THE ROLE

The dynamics within the small, mid, and large-cap segments of the Australian market are notably distinct. Large-capitalised producer companies, as shown by those in the ASX 100, generally present a lower risk profile for investors. This is attributed to their maturity, size and scale across sometimes diversified revenue streams of various products, services, and geographic locations. Additionally, their seasoned, professional management teams and well-established governance structures provide stability and protection for investors.

These companies often distribute attractive dividends, with less capital yield in some contexts. Mid-cap firms share similar traits, although they tend to issue dividends less frequently and rely on capital growth to attract investment.

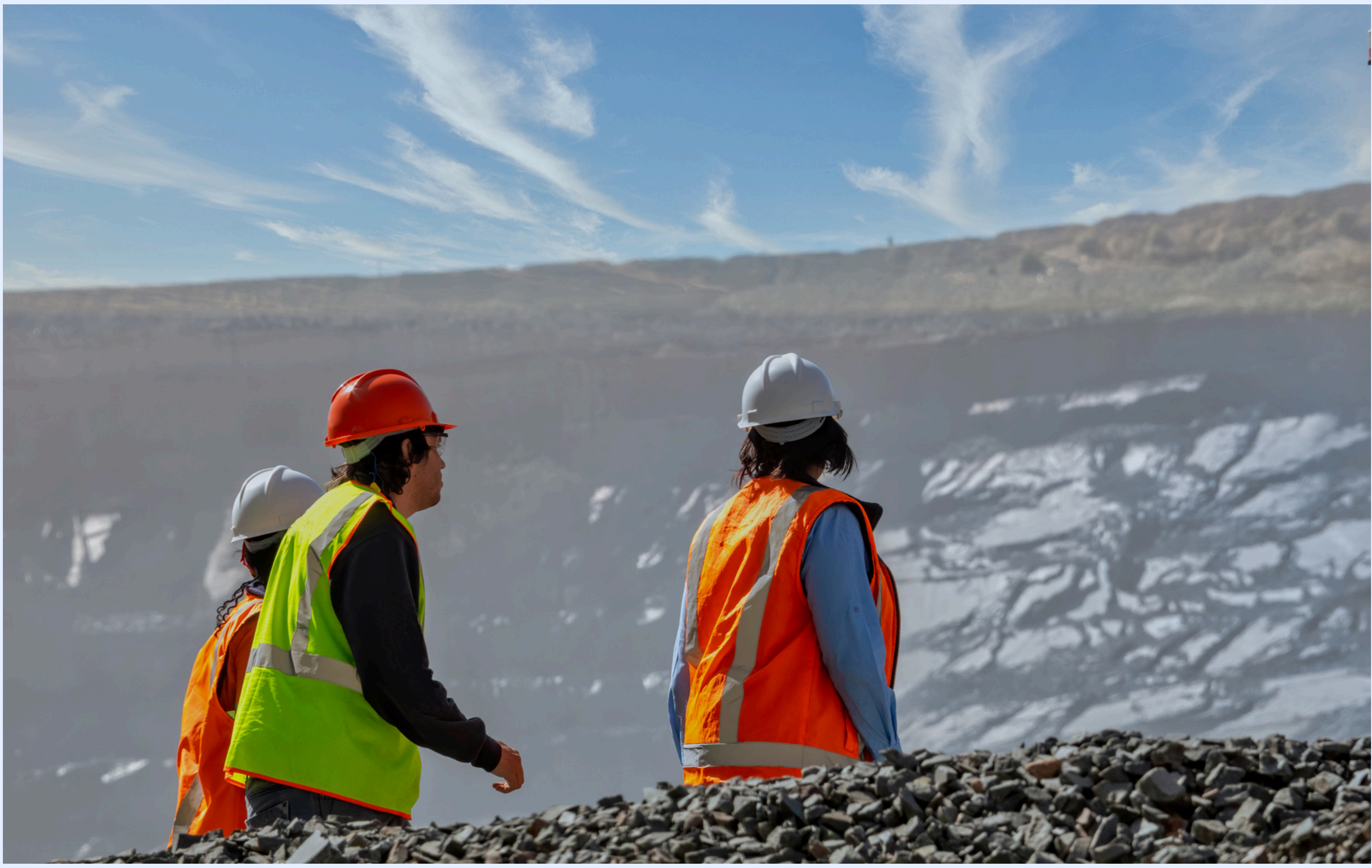
Both large and mid-cap companies typically possess ample resources and maintain clear demarcations between executive and non-executive roles within their governance frameworks as required by ASX and ASIC conventions and rules.

Conversely, small- and micro-cap companies, and in some cases mid-cap companies, differ significantly. These growth companies exhibit high capital growth potential but, like all high-potential return investments, they are characterized by considerable risk and volatility. This necessitates a longer-term investment perspective, along with active governance and stewardship. RCS refers to these types of companies as Growth Companies. In some cases, a few key shareholders dominate the company's ownership, leading to a board that may hold a significant ownership stake and/or wield substantial influence over the company's future direction.

Due to the volatility of this commodity sector and the risk profile of Growth Companies, NEDs are typically required to maintain a closer and more engaged relationship with management regarding the value creation agenda. Shareholders also expect this level of involvement.

This often necessitates a greater willingness to take on risk compared to NEDs in larger or more mature companies, where the focus on value creation may not be as pronounced. Consequently, growth boards find themselves in a unique position, enabling them to assume a distinct and more value-enhancing role. They are often recognized as considerably more proactive agents of change compared to boards in more mature settings.

As a result, the roles of NEDs vary from company to company, and a company's stage in its life cycle should partly dictate the structure and delivery mechanisms for NED remuneration.



DEVELOPING A GOVERNANCE-FOCUSED NED REMUNERATION STRATEGY

The key challenge lies in balancing the alignment of NEDs' interests with the company's value creation agenda while safeguarding their decision-making independence. This approach, when synchronized with the company's strategy, risk tolerance, and objectives, should adhere to the principles of good corporate governance and best practice recommendations.

According to the ASX Corporate Governance Principles and Recommendations:

- Principle 6: Every business decision involves an element of uncertainty and carries risks that can be managed through effective oversight and internal controls.
- Principle 7: Adequate rewards are necessary to attract the skills required to achieve the performance expected by shareholders.
- Principle 8: All principles hold equal importance.

It is important to recognize that there is no one-size-fits-all model for good corporate governance. Practices must be adaptable, evolving with the changing circumstances of a company and tailored to meet those specific needs.

Depending on the stage of development and the company's specific needs, a tailored mix of remuneration elements—including cash-based fees, performance-based equity, and service-based equity—may be employed. This approach ensures that the remuneration strategy is well-suited to the unique circumstances of the company, supporting sustained value creation and aligning with the principles of good corporate governance.

RCS would be pleased to arrange a discussion with you to determine the most suitable structure for your Board.

CONCLUSION

As high-growth companies continue to drive innovation and market expansion, the need for a remuneration framework that adequately remunerates Non-Executive Directors (NEDs) for their critical roles becomes increasingly apparent. Traditional models often fall short, failing to account for the heightened responsibilities and risks these directors assume.

To foster robust governance and sustained company success, it is essential to develop remuneration policies that not only fairly reward NEDs but also ensure their decisions align closely with the strategic objectives and risk profiles of the companies they serve. Implementing a governance-centric remuneration model, as discussed, could significantly enhance the effectiveness of NEDs in high-growth settings, ultimately supporting the broader goals of corporate governance and shareholder value creation.

About the Writer

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Allan is an experienced remuneration consultant having worked across many organisations and sectors including mining and metals, construction, and engineering and utilities.

Prior to founding RCS (formerly known as BDO Reward WA Pty Limited), Allan was founder and Managing Director of AUSREM, a boutique remuneration consulting practice subsequently acquired by Mercer; Business Leader for Mercer's Pacific Region Resources and Energy Practice; and State Manager at Hay Group Western Australia.

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