## How board remuneration impacts company success

As a result of a growing general trend towards accountability and transparency, the question of how board members are remunerated, and the direct and indirect effects that remuneration policy has on the performance and longevity of a company, are increasingly discussed.

In this article, we look at the impact of different remuneration policies, and how companies can optimize the way board members are compensated to drive long-term success.

## Calibre of directors

In a competitive marketplace, organizations wishing to attract a high calibre of directors must be willing to offer equally competitive remuneration packages. Highly qualified potential board members may expect commensurate compensation, with associated benefits.

Of course, depending on the size and financial position of a company, there will be limits to the total remuneration package available, and it's worth bearing in mind that while offering fixed compensation at the higher end of the market rate can help to attract more qualified and experienced board members, a fixed benefits only package may not guarantee their full engagement with the role, as it has no performance-related component.

## Engagement with company objectives

As well as ensuring that directors with the appropriate expertise and experience are recruited and retained, board remuneration packages need to be constructed to ensure that directors are engaged and aligned with company objectives. This means balancing fixed compensation with objective-based bonuses or stock options.

Potential board members who have a genuine interest in the company mission or area of operations may be more inclined to accept a balance that incorporates more performance-based compensation and lower fixed remuneration, which can be beneficial to smaller or less cash-rich businesses.

## Long-term value generation

If board remuneration is solely focused on the needs of directors — attracting and retaining the best talent — this may not always translate into company success. It is crucial that remuneration is linked directly to the value generated, to ensure that directors are incentivized to take actions and make decisions that align with longer-term company objectives — and effectively oversee executive management, who naturally operate on shorter-term goals.

As directors are the main influencers of long-term company success, this type of performance-related remuneration must be carefully planned to avoid the pitfalls



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associated with pursuing short-term gains which may damage the business in the long term. For example, suppose board remuneration is tied to annual profitability. In that case, there's a risk that directors are incentivized to take cost-cutting measures or reduce product quality in order to achieve end-of-year success — even if that weakens the business in the future.

## Types of remuneration

There are a variety of different ways in which board members may be compensated for their involvement, and these may differ depending on whether they are members of an advisory board or a board of directors, and whether they are executive or independent non-executive directors.

## Fixed remuneration

Fixed remuneration is the most commonly offered form of compensation and usually forms the basis of any board member's overall compensation package. The amount is usually set based on market rates and is not adjusted related to performance. As such, while it helps to attract the most qualified and experienced candidates, it doesn't necessarily incentivize success directly.

## Bonuses

Companies wishing to link remuneration more directly to board members' performance may offer cash bonuses (sometimes these may also be paid as deferred shares). This provides an incentive for directors to meet specified objectives, usually on an annual basis, which can help contribute to hitting short-term goals. Nowadays board performance is also linked to specific indicators such as ESG or diversity goals. It's important that boards carefully evaluate bonus levels and structures to align each director's performance with key strategic objectives.

## Stock options

Stock options are another common form of compensation, giving directors the right to purchase shares at a specific exercise price at a specified date in the future — usually no less than three years into the future. This can help to align board members with shareholder interests and longer-term company goals, avoiding the risk of board members focusing solely on single, bonus-related metrics at the expense of future growth and stability.

## Remuneration committees

To ensure that companies remunerate directors appropriately, in a way that retains the talent they need, engages board members with business objectives, and ensures that long-term value is prioritized over short-term gains, the role of the remuneration committee is key.

They should put in place an appropriate reward policy that balances the need to attract and incentivize directors while ensuring company objectives are met. Part of their role is also to reassure shareholders that compensation packages have been decided



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fairly and transparently with no conflicts of interest.

## Conclusion

Developing an effective board remuneration structure is critical to the success of a business. It affects the quality and talent of the board members that the company can attract, recruit and retain, and the motivation of board members to drive forward organizational strategy and exploit opportunities for growth, adding long-term value to your business.

If you're looking for support in designing competitive remuneration packages to attract directors with the specific backgrounds and skillsets needed to maximize growth and success, MEIoD can help. To find out more, visit MEIoD website or contact info@meiod.org for more information.

### About the Author:

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