Non-executive directors' Practices and fees trends report

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Contents

Appendices

This is the seventh edition of our annual review of the practices and fees trends of non-executive directors. We trust you find it informative and useful as a quick reference to current trends.

Executive summary

Gerald Seegers – Director

The benefit of having reviewed the practices of non-executive directors over the past six years is that makes it possible to identify trends and predict the way forward with some degree of accuracy.

However, the extent of the changes now taking place, for example in the social and environmental arenas, means that organisations are moving into a phase that we can only best describe as 'business unusual' and thus predictions are becoming more difficult to make.

Corporates, listed or unlisted, private or public, are fast evolving into 'purpose-driven' organisations. Gone are the days of organisations having vision statements, it is now all about how they can build meaningful relationships with their respective stakeholders.

This then begs the question in respect of non-executive directors – as a member of the board, do they support the organisation's purpose? Thereafter they can assess how they will make a contribution to the organisation executing its purpose and ultimately ensuring that the organisation does behave as a good corporate citizen.

For the first time, we look at aligning organisation's purpose with executive remuneration and discuss whether or not there should be a link and if so, how strong this should be.

As part of this significant change in business, we also see a major focus by organisations on defining their stakeholders and ensuring that they are properly engaging with them. Until now, everything has been about the shareholders and what return can be delivered to them.

However, while this remains important, shareholders and management should now be equally concerned about who their stakeholders are and how they are engaging with them. The power of social media should not be underestimated.

We take a look at stakeholder engagement for the first time, to give non-executive directors a better understanding of the risks they now face.

Finally, in order to obtain an objective view of how directors are responding to the shift to integrated thinking and reporting, we share the findings of a survey undertaken by PwC among JSE company secretaries to see how they perceive board readiness in this regard.

We trust that you will find this publication of interest and gain a better understanding of the issues, challenges and trends that we have raised and identified. We look to all our directors to play their role in ensuring South African corporates move to becoming more purpose-driven corporate citizens.

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Information

Sources of information

Data set out in this publication is drawn from information publically available on 30 November 2013 – the 'cut-off date' representing the period from 1 December 2012 to 30 November 2013 ('the 2013 reporting period').

Information has been extracted from global resources, PwC's internal resource base and the 358 active companies[1] listed on the Johannesburg Securities Exchange (JSE). The total market capitalisation value at that date was R9.677 trillion (2012: R7.546 trillion).

Fees rarely follow a normal distribution curve. For this reason, we have used a quartile/percentile range in preference to averages and standard deviations that assume normality.

These quartiles/percentiles are defined as:

- **Lower quartile** (25th percentile) – 75% of the sample earns more and 25% earn less than this fee level;
- **Median** (50th percentile) – 50% of the sample earns more and 50% of the sample earns less than this fee level; and
- **Upper quartile** (75th percentile) – 25% of the sample earns more and 75% earn less than this fee level.

Since the introduction of this annual publication in 2007, our belief remains that there is no definitive correlation between market capitalisation calculated by reference to the number of shares in issue and the prevailing share price and the remuneration of directors.

However, we are of the view that market capitalisation is a good proxy for size and complexity, and is an appropriate metric by which to set peer groups and for benchmarking purposes. It is against this backdrop that data is analysed in terms of:

- **Large-cap** – The top 40 JSE-listed companies, valued by market capitalisation;
- **Medium-cap** – 41 to 100 of the JSE-listed companies, valued by market capitalisation; and
- **Small-cap** – 101 to 358 of the JSE-listed companies, valued by market capitalisation.

Those companies that are listed on the AltX have been aggregated into the above valuations. Where the AltX is evaluated as a standalone group, it refers to 59 (2012: 59) companies with a market capital value of R17.179 billion (2012: R17.176 billion).

In addition to analysing the fees paid to chairpersons and non-executive directors across the JSE as a whole, we have also analysed fees paid by reference to four main sectors (in addition to the AltX) namely, financial services, basic resources, services and industrial.

[1] *Suspended companies are excluded*

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Board renewal: Taking a fresh look at board composition[2]

Many boards today are trying to find out if they have the proper skills and experience to guide their companies now and in the future. Each board needs to consider whether the backgrounds and experience of its existing directors are appropriate or if new skills are needed. Recently, some critics have been outspoken about their perception of deficiencies in the current state of board renewal.

Some board members themselves are questioning the competency of their fellow directors. While the majority of directors at companies with annual elections are elected with at least 90% of the vote, there are still plenty of directors dissatisfied with their board's current composition.

Early results from PwC's 2013 *Annual Corporate Directors Survey* show that 35% of the 934 directors responding say someone on their board should be replaced; up from 31% a year ago. The top three reasons cited are diminished performance because of aging, lack of expertise and lack of preparation for meetings.

"In our survey, we asked those who believe a change should be made about impediments to replacing a director," says Don Keller, a partner in PwC's Center for Board Governance. "Most indicate the biggest obstacle is that board leadership is uncomfortable addressing the issue". He added, "While it can be an unpleasant conversation, directors obviously believe the chair or lead director should take on director underperformance". This reason was cited nearly twice as much as the second and third explanations – lack of individual director assessments and ineffective assessment processes.

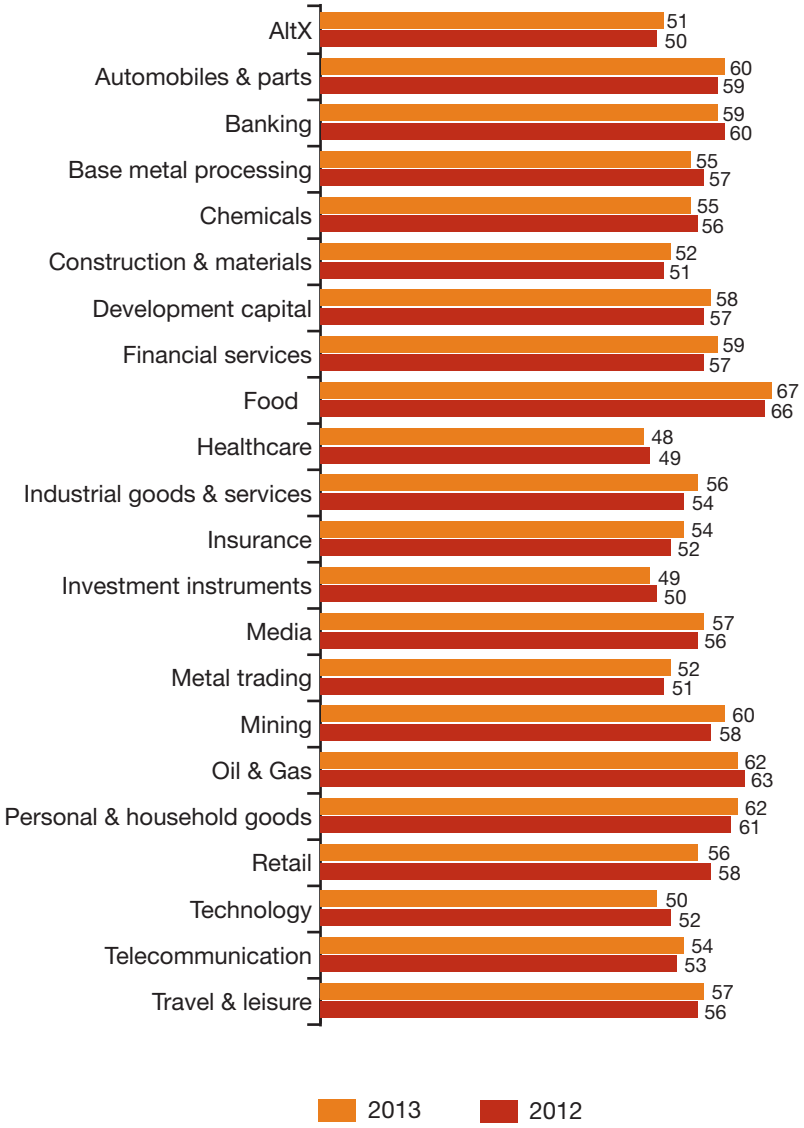
On average, directors are getting older and fewer are leaving boards to make way for the next generation. The 2012 Spencer Stuart US Board Index reports that the number of new directors has slowed to 291 of 5 184 total director seats in 2012, a 27% decrease from 2002.

At the same time, the average age of directors (68), average board tenure (8.7 years), and mandatory retirement age (72-75) have all risen. Currently, 73% of S&P 500 companies have existing mandatory retirement age policies, but sometimes they are waived. Only 4% of S&P 500 boards specify director term limits, with the majority setting the limits between 10 and 15 years.

In South Africa, for the 2013 reporting period, the overall average age of a chairperson is 56 (median is 53; 2012: 51) and that of a non-executive director 50 (median is also 50 2012: 49). The accompanying figures show the median age for each of the sectors on the JSE.

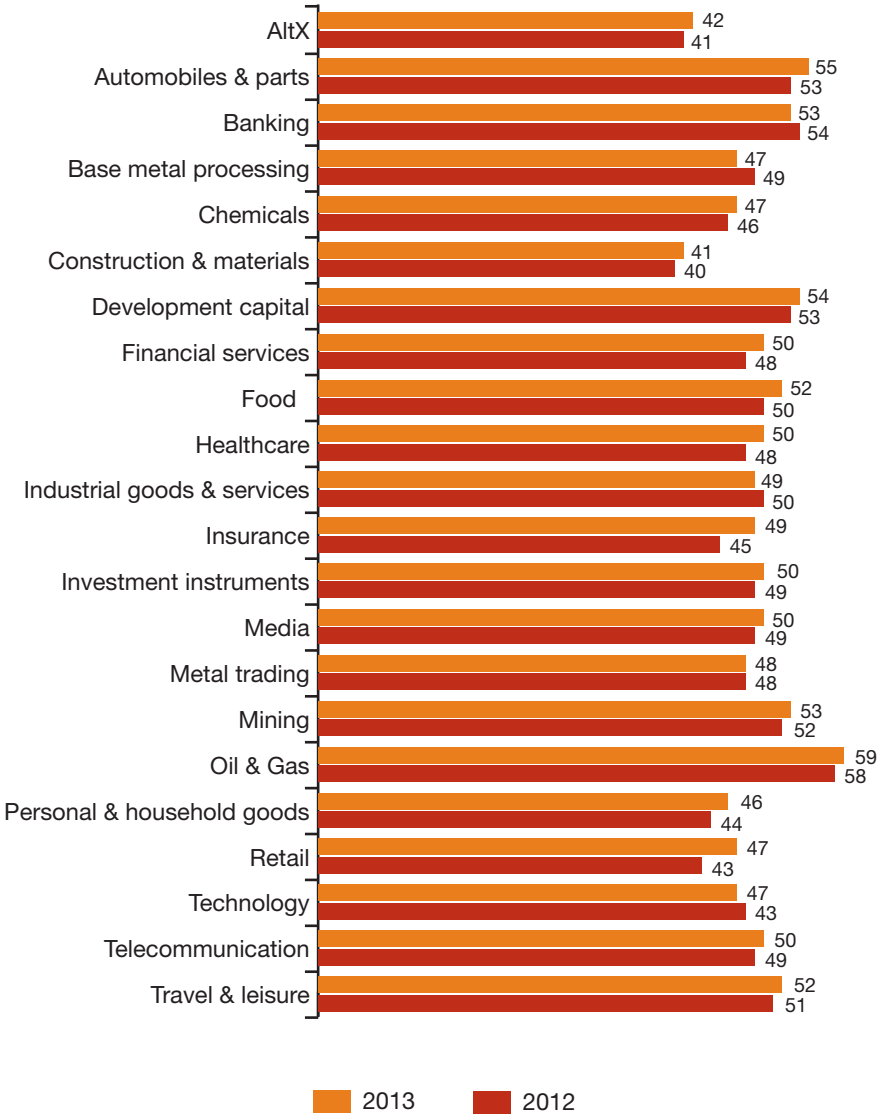
[2] 'BoardroomDirect', monthly newsletter of PwC's Center for Board Governance, August 2013

Figure 1 – Median age: Chairpersons



Source: PwC analysis

Figure 2 – Median age: Non-executive directors



Source: PwC analysis

Many proponents of board renewal suggest that a director should be replaced after a lengthy tenure since they may not have 'fresh' perspectives and because they may not be entirely independent.

Additionally, a few US boards are getting questions from shareholders about term limits and mandatory retirement age. In some situations, changing priorities or business strategies may move boards to seek out new skills.

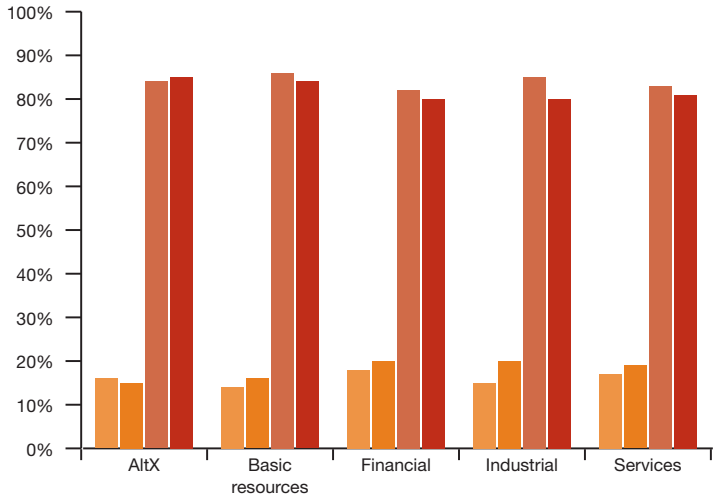
Those who argue against term and age limits point out that board members possess significant and often irreplaceable cumulative knowledge from long-term board service. They suggest that one of the reasons for low board turnover is that companies are trying to retain their talented directors, as they fear that the pool of potential new directors may not have the necessary skill sets.

Board diversity is another factor to consider when addressing board composition. PwC's survey of corporate directors found that 72% of directors consider racial diversity in director candidates at least 'somewhat important', while 74% considered gender diversity to be at least 'somewhat important'.

Meanwhile, the *2012 Spencer Stuart US Board Index* showed that 17% of S&P 500 directors are women, 91% of S&P 500 boards have one female director and 61% have two or more women on the board.

In South Africa, gender diversity on the JSE is reflected in Figure 3.

Figure 3 – Gender profile: Non-executive directors



	AltX	Basic resources	Financial	Industrial	Services
Female 2012	16%	14%	18%	15%	17%
Female 2013	15%	16%	20%	20%	19%
Male 2012	84%	86%	82%	85%	83%
Male 2013	85%	84%	80%	80%	81%

Source: PwC analysis

The percentage of women on boards of directors in all sectors in South Africa has improved, which clearly shows a trend in the right direction.

Internationally, regulators and lawmakers in some countries are going as far as requiring board diversity quotas to get more women on boards. The United Kingdom and Sweden have implemented voluntary quotas for women directors.

In 2011, Australia required publicly-traded companies to disclose the number of women serving on boards and the number of women executives. Recently, the European Commission approved a 40% quota for non-executive directors of listed companies, which will be phased in by 2020.

Director skills set

According to the PwC survey, the most sought-after attribute in a new director is industry experience (48%), followed by financial expertise (41%) and operational expertise (38%). Additionally, the demand for familiarity with 'new age' business skills (information technology, business globalisation and the influence of social media) has increased as boards look to add new directors, according to *BusinessWeek*.

In the next section we share the findings of a PwC survey undertaken in South Africa among company secretaries of JSE-listed companies.

"It's a much more challenging task today," Don Livingstone, audit committee and compensation committee member at Red Hat Inc. says about finding new directors. "There are two reasons: there's a higher level of skills that are needed and then there are all the changes in governance. The idea is to make sure the candidates have some experience in several areas so that they are not one-dimensional".

In the face of a focus on board composition worldwide, US boards are reminded of the importance of the nomination and governance committees and how vital their role is in ensuring the regular evaluation of the board's make-up in light of evolving trends and needs.

"A board's effectiveness depends greatly on its members," PwC's Keller says. "But directors are as different as the companies they serve. When it comes to composition, the most important thing for directors is to conscientiously and periodically evaluate whether the existing membership is best serving the interests of stakeholders".

Self-evaluation

One of the most effective tools boards can use to measure and ensure the competency and overall diversity of their board is self-evaluation. No matter how it is carried out – through one-on-one interviews or by filling out questionnaires – a robust process is needed for building and maintaining an effective board.

The PwC survey results show that during the past year, more than half of the boards took action on issues identified in their self-evaluation process. The most common changes were seeking additional expertise to join the board and changing board committee composition.

While some of the stock exchanges require annual board performance evaluations, the best boards go beyond a compliance requirement. They embrace the chance to refine the processes and optimise their effectiveness.

On his board, Livingstone said directors look at four key areas when conducting a self-evaluation.

"We evaluate our technical skills since we are a technology company, the broadband level of business background, experience serving on boards, as well as equality issues," he says.

Recommendations for board members

- Discuss whether the board has the right skills and experience it needs, both in light of current operations and in anticipation of future challenges. Consider analysing the current composition to identify any gaps.
- Focus on director succession planning.
- Review your local regulatory environment to evaluate whether term limits or mandatory retirement age policies need to be instituted or updated.
- Consider the views of shareholders and other stakeholders when evaluating board composition to determine whether there are any concerns with existing board policies or board membership.
- Take a fresh look at the board's self-evaluation process to ensure it is robust and has a clear and accepted objective to improve director and board performance. Consider whether director self-evaluations or peer evaluations would be beneficial or should be improved.

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Getting to the value of integrated thinking and integrated reporting

Introduction

The 21st century has ushered in monumental socio-economic, political and environmental changes, creating a fast-changing and uncertain context in which businesses must operate. As such, "to carry on business as usual could be regarded as a dereliction of a director's duty to act with care and diligence"[3].

Business cannot operate in isolation from the world in which it operates. In recognition of the multitude of dependencies and impacts that exist, the concepts of integrated thinking and reporting, formalised stakeholder engagement and the annual integrated report were mooted as a way of helping view businesses more holistically, understanding and managing the full spectrum of risks and opportunities facing organisations, and improving communication and trust between business and society.

But are directors ready to tackle their new roles and responsibilities? The three years since the publication of the King Code on Corporate Governance in South Africa 2009 have brought with them a surprisingly positive response.

While this signals a step in the right direction, it would be dangerous to assume that directors have engaged with, internalised and understood the value these new concepts bring, or that they are realising the intended value that these concepts and measures sought to reveal.

We believe that directors are on a journey, rather than having reached their destination and set out to discover how well they are placed to respond to the new requirements.

To get an objective view on how directors are responding to integrated thinking and reporting, PwC South Africa undertook a survey among company secretaries. We asked them how they perceive board readiness in this regard. Company secretaries are well placed to offer these views given their continuous access to their boards and arm's length relationship with them.

[3] "Integrate: Doing business in the 21st century" Mervyn King and Leigh Roberts

Survey approach and objectives

The survey questionnaire was sent to 65 company secretaries of listed companies in South Africa. Eighteen of these completed the survey in the designated time frame.

Our findings are based on these 18 responses and insights gained by our Sustainability & Integrated Reporting group during the board evaluations that we conduct each year.

Responses were received from companies across a broad range of industries, including energy, banking, mining, telecoms, healthcare, manufacturing and retail.

Key objectives

This survey aimed to explore the extent to which directors have:

- Grasped the impact of the unprecedented changes in the external environment in which companies do business;
- Changed their structure and/or approach to managing the risks and opportunities outside of their immediate business environment;
- Demanded an integrated approach to strategy formulation and business management from their executives; and
- Understood integrated thinking and reporting in a broader sense than simply the integrated report.

Overview of findings

We found that while directors are, in the main, aware of the requirements that have come about with integrated reporting and the need for integrated thinking, they fail to see the value that integrated thinking and reporting brings to the long-term viability of their organisations. This in turn is linked to inconsistent commitment and progress in this aspect of business performance.

We explored the possibility that non-executive directors are not given the opportunity to flex their integrated thinking 'muscle' because executive and senior management lag behind in their own application of these principles.

On the issue of remuneration, respondents across the spectrum agreed that directors should be paid more – with one proviso, that their output increases. This suggests that respondents (company secretaries) and other stakeholders still need to see a tangible difference in what directors are delivering in their adjusted roles, before being willing to pay more. At this stage outputs have not changed significantly enough to warrant full support of increased remuneration.

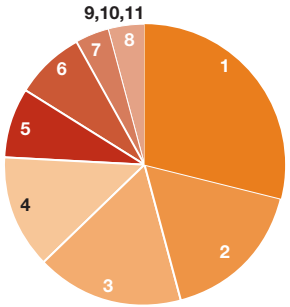
Director profile

When asked why most people seek and accept board memberships, enhancement of personal reputation and intellectual stimulation made up 70% of the votes. However esteemed the position of leadership and trust may be, this is interesting given that being a director can result in fines and personal liability for company debts, acts and omissions.

In view of the above, directors should be managing a comprehensive range of risks and opportunities and protecting themselves and the company as rigorously as possible. Yet we see apathy, a reluctance to accept change and in some cases an inability to reprogramme their minds for the 21st century.

Among the many board self-evaluations which PwC has facilitated, results have consistently shown that boards identify integrated reporting and stakeholder engagement as areas requiring greater attention and improvement.

Figure 4 – Sought-after board attributes



1.	Industry expertise	29%
2.	Financial expertise	17%
3.	Racial diversity	17%
4.	Technology/digital media expertise	13%
5.	Operational expertise	8%
6.	Risk management expertise	8%
7.	International expertise	4%
8.	Gender diversity	4%
9.	Human resources expertise	0%
10.	Legal expertise	0%
11.	Marketing expertise	0%

Source: PwC analysis

When asked what the most desirable attribute for a new director is, nearly a third of respondents identified industry expertise. It is not surprising that generic business acumen is falling in importance, as being able to understand and test the business model lends itself to better value creation. It also fits with the current view that directors need to be more in touch with the business and the context in which it operates in order to be on top of the risks and opportunities that present themselves.

Gender and racial diversity may not immediately appear to add value, but are good examples of the necessity to take into account external pressures, which will ultimately impact the long-term viability of South African businesses.

Risk management skills ranked low, which is surprising given that risks are defined as those issues that may prevent an organisation from achieving its strategic objectives and one of the main functions of the board is to ensure that goals and targets are achieved.

By rating industry experience at the top of the list of desirable attributes, boards may feel that operational risks are being covered. But, by rating HR (employees), marketing (customers), and compliance as of minor importance, suggests that stakeholders and stakeholder risk are being grossly underestimated.

Risk and opportunities management, strategy and materiality

When asked how much time the board spends on risk management, most responses were in the 25 to 50% range. Of this time, most was spent on financial, reputational and information technology risks, although a very wide variety of other risks were also mentioned.

In our experience, the wide range of risk issues being dealt with by boards is symptomatic of the reactive manner and short-term approach many take in addressing risk issues. We believe they should rather become more proactive by implementing a formal stakeholder engagement framework that has the ability to focus on most material risks, no matter what the timeframe dictates.

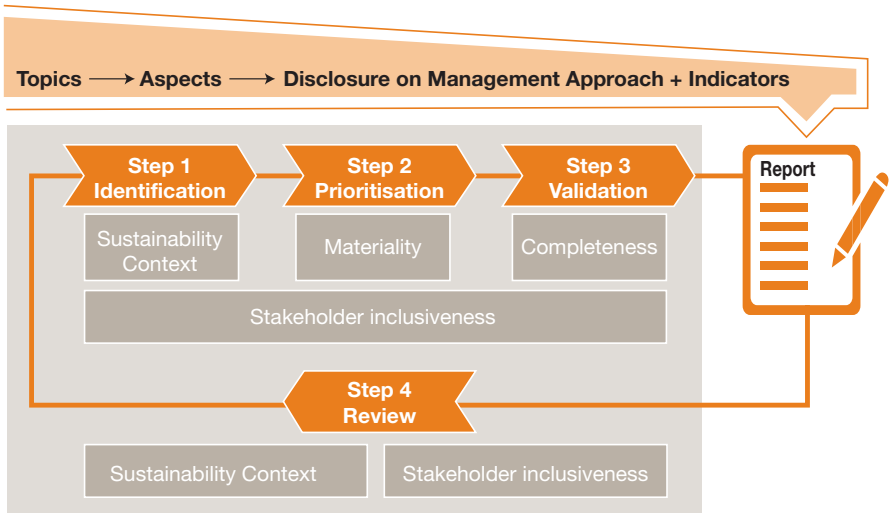
When asked how the organisation ensures that the most critical risks reach the board's attention, respondents explained at great length the systems and processes they have in place to make this happen. However, none of these responses convinced us that the board had timely sight of, and therefore input into, determining the most material issues facing the company.

A recent media report published by the Integrated Reporting Committee of South Africa[4] says that "another concern is that most companies are not disclosing how they carried out their report materiality process. Only 24 [of the 100 appraised] of the reports had good disclosure in this area."

It is our belief that risks are still being dealt with in the various board committees and that each committee brings to the board what they consider to be the most material of their issues. As the highest decision-making body in the organisation, the board is expected of to make the final judgment on what is most material overall. So far in our work, we have not seen this on board agendas as various risk reports, each in their own silo, are presented in isolation.

[4] "The diminishing size of the corporate report", The Integrated Reporting Committee of South Africa, December 2013. https://www.saica.co.za/News/NewsArticlesandPressmediareleases/tabid/695/itemid/4377/language/en-US/Default.aspx

Defining material aspects and boundaries



Source: Global Reporting Initiative Sustainability Reporting Guidelines

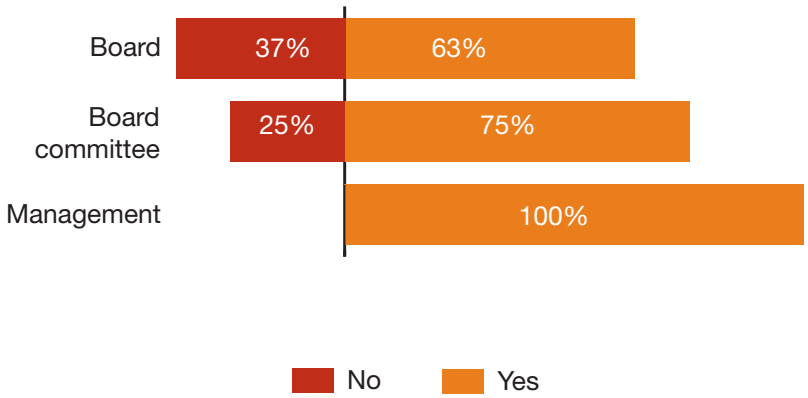
Stakeholder engagement

The only survey questions for which respondents were in complete consensus were the 100% responses we received to these questions:

- Does your board include stakeholder (external) risks as part of its definition of risk?
- Do stakeholder issues appear in the risk reports?

A large majority of respondents also believe they have a useful stakeholder engagement policy in place.

Figure 5 – Level at which stakeholder engagement is dealt with



Source: PwC analysis

These responses indicate a leaning towards compliance (application) given that our board evaluations suggest that directors and members of the executive committee do not see the point in utilising the stakeholder systems and processes that are in place for value creation and to inform strategy.

Boards in particular appear to be at arms-length from these processes and indeed from the stakeholders themselves. There is still a need to determine the role of the board with regard to stakeholder engagement and, while no one size fits all, we believe that as a minimum the directors must:

- Oversee the process of identifying material stakeholders;
- Ratify the stakeholder engagement process;
- Ensure that risks and opportunities are managed/exploited and reported on; and
- Engage directly with stakeholders where appropriate.

Integrated thinking and reporting

While the survey finds that companies are addressing value creation across all six capitals contained in the International Integrated Report Framework, there is little practical evidence to show that all the capitals are understood and utilised to the same extent that financial capital is.

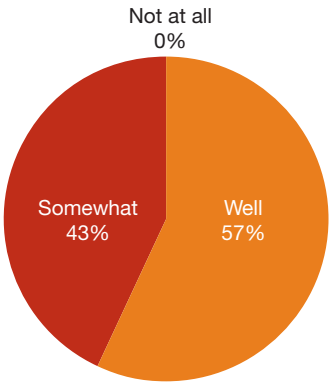
Nevertheless, when asked whether non-executive directors are up to date in terms of their acceptance and knowledge of integrated thinking and reporting, 86% of respondents said yes. More telling though are the remarks that accompanied this answer, which ranged from 'sufficiently up to date' to 'not all directors' and 'reluctantly so'.

It is these comments go to the root of the problem, for as long as members of the executive committee merely pay lip service to this new way of doing business, and as long as they are driven by application of a standard rather than extracting value from the standard, the feedback loop to non-executive directors in particular will remain open, allowing for important decision-making data to be lost along the way.

For however long management is tasked to tackle non-financial risks and opportunities in isolation of the bigger picture and in a fragmented manner, directors will struggle to see the value and will not take a proactive approach in changing and determining strategic direction.

When questioned on how well their executive committee is prepared to respond to the same issues facing the board with regard to integrated thinking, stakeholder engagement and integrated reporting, only 57% answered in the affirmative.

Figure 6 – Extent to which the executive committee is prepared to respond to the issues of integrated thinking, reporting and the integrated report



Source: PwC analysis

Given that the executive committee acts as the conduit between the business and the board, it is safe to say that only 57% of these boards (or less) have a chance of being on top of this new way of doing business. For this system to add value, the information supporting the board's ability to strategise, direct, monitor and reflect, must be material, complete, contextualised, informed and accurate.

While our survey shows that some boards do get involved in the planning and development of the integrated report, rather than just signing off the contents at the end of the process, it is our opinion that boards should get involved in the integrated reporting and thinking process throughout the year.

Executives and board members alike should be involved in deciding the themes for the report and indeed the minutes of the board meeting should provide a framework for the report content if the system is working as it should.

It is interesting to note that the Integrated Reporting Committee of South Africa's report highlighted as one of two major concerns the following:

> *Not all of the [top 100] reports carried a statement from the company's board of directors endorsing the report. This is important as a test of the credibility of the report and information it contains. There is international preference for such a statement and while there has been come criticism about its inclusion, it is a fact that in many jurisdictions directors are responsible for corporate reporting anyway. The 2012 research revealed that 37 reports carried prominent statements with 8 others showing less prominent endorsement by the board. These figures are slightly lower than the 2011 findings.*

While the additional responsibilities for integrated thinking, stakeholder engagement and integrated reporting place greater liability on the shoulders of directors, most respondents do not believe that liability cover for directors should increase. We agree wholeheartedly. If these roles are properly undertaken, risks will go down, both for individual directors and the organisation as a whole.

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Stakeholder engagement

Depending on the stakeholders, investors and analysts aside, stakeholder engagement still tends to be management-driven, fragmented and even ad hoc. Non-executive directors in particular, except perhaps chairpersons, who may take on various functions and appearances on behalf of the company, operate almost exclusively from an internal perspective.

This type of interaction is by its very nature limited in extent and secludes management and directors away from the real world. Barriers are fast being destroyed as accountability widens beyond the confines of internal decisions. Former boundaries between boardrooms and the rest of the world are a thing of the past.

Business conditions in the last five years have changed dramatically. All business today is conducted in the face of different spectators who in time gather into special interest groups with disparate agendas that often appear totally disconnected from the matter of running a business.

Shareholders face the possibility of becoming the minority stakeholders in the business. They may be outnumbered by many factions that may be directly involved in the business, or be what was previously classed as outsiders.

Today the term 'stakeholder engagement' is emerging as a means of describing a broader, more inclusive and continuous process of communication between a company and those potentially affected by it. This encompasses a wide range of participants and activities –including the way the management runs the business.

A broader formalised and more inclusive and continuous process is emerging where this interaction will escalate and companies will have a representative arrangement –even to the extent of having an ombudsman of stakeholder affairs.

This change reflects broader changes in business, especially in the financial and mining sectors, which increasingly recognise that the business and reputational risks that come from poor management, necessitate a growing emphasis on good corporate citizenship and transparency of action.

In essence, stakeholder engagement is about managing material risks and opportunities external to the financial and operational aspects of the business in order to ensure the long-term viability of the company.

The spectrum of social engagement with stakeholders and managing this now entrenched expectation will not change any time soon and the demands placed on organisations will increase as social media becomes ubiquitous.

A model for stakeholder engagement

Companies should design their engagement strategies in line with the perceived needs of the group that poses the greatest threat, but also include those groups that offer opportunities too. These groupings may include company employees, trade unions, customers, consumers or any other action groups. The strategy adopted should be proactive and structured in such a way that it does not disrupt day-to-day business.

Start soon

The first rule is to get in early – do not wait until there is a problem to engage. To build a relationship takes time. Understanding, trust and mutual respect need to be real for difficult engagements. These attributes are intangibles that develop over time. A proactive cultivation of transparency early on can serve as a paramount asset in the event of challenging times.

Establish a long-term horizon

Companies that take this approach tend to make different types of decisions. They ensure that information translates in such a way that there will be no misunderstanding around their actions and strategy.

Fit the policy to suit your company

Companies should scale their stakeholder engagement framework relative to the risk impact the future interaction it is likely to create. The outcomes will have an impact on the future business strategy and decision making.

Manage stakeholder engagement as a business function

Stakeholder engagement is a permanent paradigm. Like any other business function, it requires effective management. Ultimately, it is the function of the board to make the judgement calls around prioritising stakeholder risks and opportunities. This should be coordinated at executive committee level and be overseen by the board.

6

Risk of claims against non-executive directors

The spectrum of risk haunts directors and management alike on a daily basis. Management often views non-executives as non-employees who visit the company to attend meetings because meetings are a legal requirement, and do not contribute effectively to the challenges facing them at the coalface. Conversely, executive directors look to non-executive directors as fellow leaders in meeting strategic goals.

It is a given that non-executives need to devote more attention to risk than they currently do. Structured risk discussions ought to form part of the management process and run throughout the organisation. If this is ineffective, then management and staff will hold the incorrect view that non-executive directors are merely occasional visitors.

Non-executives should ensure that the company's employees grasp the importance of a changing world – a scenario that changes daily, and involves an agenda that was not up for discussion even a few years ago.

There is a firm requirement for non-executives to spend more time on board work, with the prospect that the results suggest real benefits. This is especially so in high-impact boards. Spending more days per year on their work is likely to help them stay relevant and engaged with important company matters.

Greater scrutiny from a plethora of stakeholders inside and outside the company means the watchman is on guard at all times. The director should be equally vigilant and run his or her business accordingly. This condition is not conducive to normality, as anybody may at any time trump up charges, which require a careful defence to ensure survival.

Most directors have worked a lifetime to achieve success. However, they may be accused at any time of dereliction of duty. Unfortunately, it is the crimes of the few that have structured rules for the many.

To meet these challenges non-executives need to research what other boards are directing their attention on, and not only when it comes to strategy. Using robust financial metrics is a first requirement. Conducting post-mortems of major projects and finding ways of creating competitive advantage in an ever-changing world is another. What was good enough yesterday, may not be today.

Non-executive director insight should be honed to a point where the people within the company will look with keen anticipation for advice about the company and its future.

The new Companies Act, 2008 clearly indicates that responsibility is shouldered by all who hold positions of trust in managing the affairs of a company. The Act applies to all responsible parties, but in particular, to directors. This includes non-executive directors be they non-independent or independent. The fiduciary risk is greater today than ever before.

Directors who are tardy in discharging their duties, now face the prospect of being branded delinquent. In terms of Section 162 of the Act, a wide range of stakeholders may apply to court to declare a person derelict as a director. Personal damage to directors may be severe.

Non-executive directors may be more vulnerable to risk since they are not fully involved with the daily affairs of the company and control is distant. Their position is similar to that of trustees. As such, stakeholders look to them to display ethical leadership while protecting the interests of the organisation.

Protection for non-executive directors

The Act provides limited protection for directors under the 'business judgement rule'[5], which allows directors to escape liability in certain instances where they can prove:

- They acted being fully informed about a particular matter;
- They were not conflicted in the matter; and
- With the wisdom of hindsight it appears that there was a rational basis for the business judgment call.

While this rule provides an important defence for directors, it may still be extremely costly to defend a claim in this way and directors' and officers' insurance cover should be considered by all companies.

Quality not quantity

The non-executive director must remember that it is quality governance that is important and not a mindless checklist approach to compliance. Directors must act with intellectual integrity and in the best interests of the company. They must ensure that they are party to the board's collective decisions and these result in the company being and being seen to be responsible, accountable, fair and transparent.

[5] S76(4) of Act 71 of 2008

7

Economic crime

Fraud, corruption and cybercrime are global issues. Given the wide range of responsibilities covered by the new Companies Act, these crimes may point to shortcomings in corporate culture and insufficient controls within the company. Non-executive directors will need to defend their actions.

With Africa showing steady growth and business opportunities beginning to increase, so too do the opportunities for economic crime and the need for companies to implement programmes to protect themselves.

According to the South African edition of PwC's 6th Global Economic Crime Survey published in November 2011[6], South Africa has a higher incidence in every category of economic crime except insider trading, when compared to global results.

[6] The full South African report may be downloaded at http//www.pwc.co.za/crimesurvey, and the PwC Global Economic Crime Survey 2011 –Global Edition at qqq.pwc.com/crimesurvey

South African respondents in the survey were also not as likely to stop doing business with organisations whose employees were responsible for fraud attempts. The survey found South Africans more likely to report external fraudsters to law enforcement, but less likely to take civil action than their global counterparts.

The 8th Global Corruption Barometer published by Transparency International in July 2013 shows that respondents in 21 African countries (including North Africa, sub-Saharan Africa and the Indian Ocean islands) believe that corruption and lack of transparency are getting worse in their countries[7]. Of the respondents in South Africa 43% said that in their dealings with the public sector, it proved 'very important' to have personal contacts to get a deal done and 47% said they paid bribes.

There is, however, a strong belief that civil society could play an important role in stopping corruption. In South Africa, there is a dominant view that reporting economic crime to the authorities will achieve very little because of severe shortcomings in the criminal justice system.

[7] Transparency International Global Report 2013

Companies have to take ownership of these challenges and fight fraud and corruption. One of the major risks of fraud in any organisation is employees with third-party interests that their employer is unaware of.

Undeclared financial conflicts of interest are indicative of poor internal controls and carry major risk, not only financial, but also reputational risk and potentially also legal risks relating to breaches in competition law, labour law and other regulatory requirements.

South African crime statistics released by the SAPS in September 2013 show that 5 900 crimes were reported to SAPS every day –that is more than two million in the last 12 months.

It is estimated that R650 billion has been lost to corruption in South Africa in the last 18 years.

Bringing a civil case against perpetrators is time consuming and very costly. Any claim above R100 000 is beyond the jurisdiction of the Magistrates' Courts, and will escalate to Regional or High Court. Many companies decline to go this route because of negative publicity and the time and money required.

Taking remedial action

As the risk of fraud and corruption becomes greater and ever more complex, they are easy to miss and require highly specialised skills and experience to identify and mitigate.

One way to combat fraud and corruption effectively is the use of technology. Another is the use of an experienced forensic practitioner. In the past, forensic audit services were mainly used to investigate and gather evidence of fraud for submission in a disciplinary hearing or court of law. With the advent of King III, their role is now aimed at detecting and preventing fraud with the use of a number of measures and technology.

King III states that it is essential for an organisation to implement systems that identify risks early and continuously and then to establish internal controls to mitigate such risks. Ethical codes should be adopted and be supported by effective communication channels.

King III also recommends that the audit committee should direct and supervise any investigations. In addition, the Companies Act[8] requires the establishment of a social and ethics committee whose mandate is to ensure that a company complies with relevant legislation and best practice.

In addition, a key corporate governance responsibility should be to facilitate confidential whistle-blowing mechanisms and to ensure that whistle-blowers are not penalised.

[8] Section 43(5)(a)

8

Aligning the company's purpose and executive remuneration

What is purpose?

There is increasing evidence that purpose-driven companies that build more meaningful relationships with their stakeholders transform their business and grow their earnings. Hence, engagement with stakeholders is becoming critical to the sustainability of organisations. By connecting effectively to their stakeholders, they begin to differentiate themselves from their peers, motivate employees and, most importantly, inspire their customers by showing that they care about them.

The shift has happened – organisations now have to re-evaluate the value they are delivering not only to their shareholders, but also to wider groups including the community and ultimately society. Having a purpose requires an organisation to understand its role with all its stakeholders. While its business objectives may not be about changing the world, its stakeholders' objectives may be.

With an increase in awareness of, and active involvement in, improving society and sustainable development there is a knock-on impact on business to do the same.

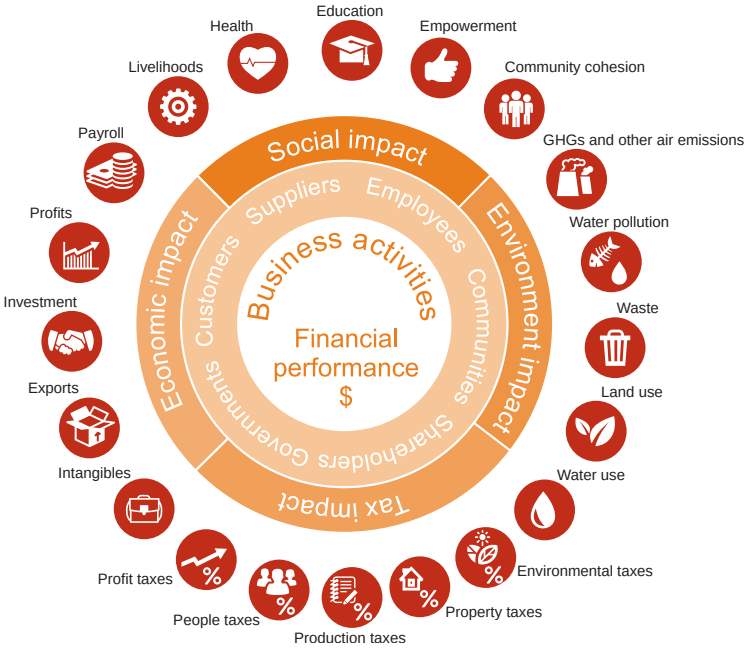
All of this comes in addition to driving traditional financial performance, but failure to introduce 'purpose'-driven metrics may in today's rapidly changing world mean ultimate failure.

All organisations are looking for growth and the global desire for growth creates employment, reduces poverty and generates the income to fuel a progressive and stable society.

PwC has developed the Total Impact Measurement and Management (TIMM) tool, which allows organisations to carry out an impact study that puts a value on an organisation's activities.

The TIMM framework puts a value (positive or negative) on 20 impacts across society, tax, economics, and the environment. It gives business the ability to compare strategies and investment choices, evaluating the total impact of each.

The TIMM framework



As these impacts can be measured, they can also be monitored and managed, which ultimately means that directors can be held accountable and rewarded for their efforts.

Link with remuneration

TIMM provides a holistic understanding of how an organisation's business activities deliver value to the supply chain and communities in which it operates, through its contribution to the economy, public finances and its impact on the environment and wider society. In this way, it provides a comprehensive assessment of how organisations generate and potentially, destroy value for shareholders and other stakeholders.

Traditionally, executives chased sales and financial performance to drive their short-term and long-term incentives. Financial profitability can no longer be the only driver – instead, profitability should be a gauge that the organisation is actually providing something that its consumers and society want.

Having a meaningful purpose necessitates that organisations bring economic, fiscal, societal and environmental metrics together in a way that is relevant to the organisation and its stakeholders. In so doing, it will differentiate itself from

its peers. At the same time, linking executive remuneration to this holistic view of performance, would be more defendable to stakeholders and drive the kind of ethical leadership needed to ensure the organisation remains a sustainable and profitable corporate citizen.

Strategic approach

After the financial crisis in 2008, the misalignment between the level of executive remuneration and the underlying performance of organisations became the centre of attention. Since then organisations have been reviewing and addressing the many shortfalls in their existing incentive schemes following pressure from a number of stakeholders, including shareholders.

The financial services industry was the first to react and almost immediately we saw a plethora of guidelines being issued and regulatory interventions from governments and various other authorities.

Changes in executive remuneration will also be necessitated as organisations adapt to changes in their operating models and business strategies and ongoing scrutiny from stakeholders. Aligning executive remuneration with the organisation's changing business model will assist in attracting and retaining the people it needs to take the organisation forward.

With this in mind, we look at how organisations can develop a more sustainable and strategically coherent approach to pay and incentives[9].

- **Engaging with stakeholders**
  With all the new regulations around the world including some very restrictive proposals, it is important that organisations put forward their case for the most workable arrangements to their stakeholders. This would include communicating the limitations, challenges and implications for jobs, growth and competitiveness coming from the business model changes.

- **Aligning pay considerations with decisions over where and how you operate**
  As organisations expand into Africa and elsewhere in the world, looking for the most viable new locations, it is important to consider resourcing and reward – whether the right people can be hired locally or would need to be reassigned from within the organisation.

- **More realistic packages**
  It is likely that for organisations to remain competitive, a number of top earners, mostly executives, will need to be paid less – these conversations cannot be put off indefinitely. Executives and employees may be more receptive to a new 'bargain' than is often presumed.

- A global survey of more than a thousand financial services executives – carried out by PwC in 2012 – found that most prefer the assurance of fixed pay over the higher risk 'gamble' of a bonus, even if the latter could offer more money. This suggests that in the financial services industry for example, executives are more risk-averse than is often presumed.

- Employees affected by the changing business model, whether by regulation or any other factors, may also have to give ground. Packages will need to reflect the fact that variable pay loses value the longer people have to wait. A bonus for example, deferred for three years, is typically discounted by around 50%.

- **Rewarding the behaviour you want**
  It is important to look at how well reward strategies reflect the risks, returns, desired behaviour and culture of the organisation. In the financial services industry for example, regulation and market pressures are shifting them towards a longer-term and relationship-driven customer solutions approach. The structure and horizons of an organisation's reward policies should reflect the emphasis on the stakeholder outcomes.

- **Forging a new career bargain**
  A strategic approach to executive remuneration will consider the new regulatory structures, and how to adapt or concentrate roles that attract regulated responsibilities. A key priority will be how to restore cohesion in incentives and

[9] PwC Smarter incentives: Turning the regulatory shake-up to your advantage (adapted)

motivation. This could include creating explicit career steps for executives who move between the more and less prescriptive jurisdictions over the course of their careers. Opportunities to gain experience and develop their careers can be aligned with a career earnings model.

- **Money may not be the chief motivator for the people you need**
  The importance of non-financial motivations is going to increase as the millennial generation moves up the ranks to take up managerial positions – a PwC survey[10] of graduates in the financial services industry, highlighted the importance of jobs with meaning and interest as a key attraction for this generation.

- **Rebuilding trust**
  The underlying imperative is to win back the trust of stakeholders needed to ease the political and public tensions over pay and regain control over executive remuneration.

  Communicating how the activities and value created by organisations support the success of the wider economy and how the reward model promotes the various stakeholders' objectives will form a crucial part of the overall task of rebuilding trust. This trust is critical over the longer term, as it is fundamental to the 'licence to operate', which underpins the pursuit of profitable opportunities.

[10] PwC Millenials at work: Reshaping the workplace in financial services

9

New metrics for executive remuneration

Probably the most popular metric traditionally used to set executive remuneration is to ensure the company is generating returns above the company's cost of capital. This is meant to give shareholders comfort regarding the investment they have made and ensure a sustainable return.

Social and economic criteria, including employment diversity, have now become more meaningful metrics. These criteria cover a broad spectrum of non-financial measurements that are hidden from day-to-day accounting, but have a direct and significant effect on the well-being of the company.

Some commentators have labelled these measures 'soft' key performance indicators, but since they will ultimately determine the future of the company, they should become measurements that directly determine remuneration and incentives paid to executive directors.

These indicators differ widely depending on the type of company and its business profile. Broadly accepted functions such as customer service may be very important criteria where the quality of daily contact with the client is the benchmark by which leaders in the boardroom are measured.

Customer service is a reasonably easy measure, but issues such as climate change and the carbon footprint produced by organisations' day-to-day operations are far more challenging to manage and measure.

This is a complex subject that requires deep introspection at board level. The most useful insights will not come from the kinds of high-level metrics executives usually use to assess business's value creation potential, such as return on invested capital, economic profit, and top-line growth.

Although necessary, such metrics do not reflect the underlying causes of the value creation in the long term, but should be viewed as financial indicators supporting the sustainability of the business.

Finding the right metrics to apply to director remuneration is therefore an item that should begin to appear on the agenda in every boardroom.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Governance update

United States – CEO pay ratio

The Dodd-Frank Act calls for the SEC to write a rule requiring public companies to disclose the ratio of it's chief executive's compensation to the median employee pay. This rule was promulgated at the end of September 2013. The aim of the rule is to highlight the pay disparity between top executives and general employees at the biggest and largest US companies.

Whether the rule will actually narrow the gap between employee compensation and executive compensation is debatable for a number of reasons

- **Disclosure, not enforcement**
  This rule, as with the 'say-on-pay' rules also enacted in terms of the Dodd-Frank Act, does not require companies to change anything about the remuneration structure of their CEO and other executives. All it requires is disclosure. While this may create some discomfort for the CEO, the rule does not require any changes to remuneration policies.

- **The 'flexible' calculation methodology**
  No specific methodology is provided for calculating the pay ratio, giving companies the flexibility to determine the median annual total remuneration of employees in a way that best suits their circumstances. It will therefore probably not be possible to compare the ratios of different companies accurately due to the differing calculation methodology employed.

- **Administrative costs**
  Executing these calculations, running the ratios and putting together this additional level of disclosure will require a coordinated effort. Especially if you take into account that the initial proposal suggests that the calculation should incorporate the remuneration of all employees in the Group (i.e. of all subsidiaries of US companies, everywhere in the world and not just full-time US employees). More reliance will be placed on lawyers, accountants and remuneration consultants resulting in a cost which will most likely be passed along to shareholders.

Another concern noted in the US is that the rule may have some unintended consequences. For instance, it might encourage further outsourcing of relatively low-wage work to foreign companies, depressing employment of workers. This could result in the average pay of the median worker increasing, but only if you do not count the zero wages being earned by those who could be laid off as a result of this law.

US regulators are still receiving comments and feedback on the rule and it will be interesting to see what transpires in future.

Switzerland – Referendum on limitation of executive pay

In March 2013 Swiss voters voted overwhelmingly in favour of banning golden hellos and golden handshakes for executives coupled with an annual binding 'say-on-pay' vote by shareholders.

Following this, a national referendum concerning limitation of executives' pay was called on 24 November 2013. In this referendum voters rejected the proposal to limit executive pay to 12 times that of the lowest paid employee Had this rule been approved it would have given Switzerland the world's toughest pay rules and some of the lowest executive salaries.

The no vote followed warnings from industry leaders that the measure could harm Switzerland's economy by restricting the ability of firms to hire skilled staff, forcing firms to decamp abroad and resulting in a shortfall in social security contributions and higher taxes.

Although the proposal was defeated, the issue of high salaries and widening wage gap has not gone away. Early next year, Switzerland will hold another referendum on a guaranteed minimum wage.

France and Germany – Maximum pay ratio and employee stakeholders

In May 2013 the new socialist government announced that all companies in which the French state holds a greater than 50% stake will cap their executive's pay at 20 times that of their lowest-paid employee. The 20:1 pay ratio will apply both to new and existing business leaders and will impact over 50 businesses, including major companies such as Areva and EDF.

The choice of a 20:1 limit is a somewhat arbitrary measure and it is too early to judge its success. It will initially only apply to state-owned companies and will serve as an example for most executive pay packages, rather than a firm limit.

In Germany, boards operate a system of 'co-determination' comprising a management board with day-to-day responsibility for the company and a supervisory board, providing strategic oversight. The supervisory board is divided equally between shareholder representatives and elected representatives of the company workforce. Historically, decisions on executive pay were delegated to a separate remuneration committee. However, for the past four years, the supervisory board has had responsibility for setting levels of executive pay, meaning that elected employee representatives now have a say on their bosses' pay.

United Kingdom – Final regulations on directors' remuneration disclosure[11]

Final regulations on directors' remuneration disclosure were released by the Department for Business, Innovation & Skills (BIS) on 7 June 2013 and will apply to all UK companies that have a listing on a major stock exchange and will replace the existing requirements for years ending on or after 30 September 2013.

The new-style reports will be subject to shareholder approval (binding in the case of the policy part) at the shareholders' meeting held in the next financial year or in 2014 for 31 December year end companies. Remuneration payments must be consistent with that approved policy from the beginning of the subsequent financial year (1 January 2015 for 31 December year end companies) unless the company elects for an earlier date.

Although some companies have taken significant steps towards the adoption of the new rules in their 2012/13 remuneration reports, others will be faced with a major overhaul of their reports this coming year. Remuneration committees now need to consider how they will present the company's policy in a number of additional areas and how their decisions and the resultant outcomes will be reflected under the new regime.

Remuneration committee chair's statement now the annual statement

There is no change to the content of this statement but a slight change in emphasis. The statement needs to explain the context in which the decisions and changes were made, not just the backdrop to the report.

Implementation report now the annual report on remuneration

BIS has recognised that the previous draft regulations were very prescriptive about the form and content of the table displaying the single total figure. This may have made it difficult for companies to present the single total figure in a way that was consistent with other areas of their report. The regulations now allow:

- Headings to be used for columns or rows
- Order of the rows or columns to be altered if sub-totals are necessary to aid understanding; and
- Additional rows or columns, providing details of how the figures were calculated and any performance conditions are disclosed.

The regulations clarify the treatment of long-term incentives (LTIs) in the single figure where the performance conditions are substantially met at the end of the financial year. An estimated amount can be included in the single figure for the financial year, but in the subsequent financial year the actual amount should be disclosed (without recognising the 'true-up' adjustment separately in the subsequent year). The regulations also spell out how any amounts clawed back should be disclosed.

All pension scheme benefits now need to be calculated in accordance with the HM Revenue & Customs method, substituting 20 for 16 when estimating capital values. Unfunded arrangements must also be disclosed by recognising the value notionally allocated together with any notional investment return achieved during the financial year.

The nature of any benefits in kind included in the single total figure must be disclosed together with the value, where significant. The term 'significant' isn't defined but should be interpreted in terms of significance to the individual rather than to the company.

Scheme interests awarded during the financial year (auditable)

The regulations are now clear that disclosure must be made of LTIs awarded during the financial year, rather than in respect of the financial year. Notes to the table are required to specify the share price used at the grant date, whether an average share

[11] PwC UK : **Clarity at last** Final legislation on directors' remuneration disclosure – June 2013

price is used and the period over which any average was measured.

The table must disclose, for any share options granted, the difference between the exercise price per share and the share price used to determine the number of awards granted.

Payments to past directors (auditable)

- The regulations specifically exclude from the requirement to disclose payments to past directors any that are:
- Payments for loss of office (for the purposes of the regulations);
- Included in the single total figure;
- Disclosed in a previous remuneration report;
- Which are not of significant economic value;
- By way of regular pension started in an earlier year;
- Of dividends on LTIs retained, and;
- For employment or other contractual service other than as a director.

This is a useful clarification that would have been just as relevant under the pre-existing legislation.

Statement of directors' shareholding and share interests (auditable)

This provision has now been clarified and is required for any director who has held office during the financial year. It includes all the share interests held by them and people connected with them. The table must differentiate between shares and share options and provide details of LTIs (unless provided elsewhere in the report). In the case of options, the table must provide details of:

- Vested but unexercised options; and
- Options exercised in the financial year.

This is now an auditable disclosure.

Percentage increase in remuneration of CEO

The proposed comparison between the percentage increase in CEO and employee pay has been widely regarded as a meaningless disclosure. BIS appears to have recognised the inherent volatility in a measure of CEO pay that includes LTIs and has stripped this element out of the comparison. It's not entirely clear from the regulations whether the comparison of increases is required for each element (i.e. separately for salary, fees, benefits and annual/deferred bonus) or whether it is the comparison of the increase in total. Given that annual bonus has still been included, this will remain a potentially volatile disclosure.

Relative importance of spend on pay

Originally, the purpose of this disclosure appeared to be to highlight the proportion of distributable profit laid out in respect of directors' pay. Examples mocked up for BIS showed the percentage of profit appropriated to directors' pay to be so small that it didn't register on the chart. The regulations no longer require separate presentation of the aggregate expenditure on directors' pay.

This disclosure is still required, but with flexibility for directors to choose which elements of expenditure to compare with the expenditure on total pay and dividends (plus share buybacks) mandated by the regulations. The choice of items of expenditure disclosed and how they were calculated must be explained, together with a justification for any change in the items from year to year.

For all measures, the graph or table must show the actual spend for the financial year and previous year and the difference in spend between those years.

Statement of implementation of remuneration policy in following financial year

A new requirement has been included in the regulations to explain how the company will implement remuneration policy in the forthcoming financial year. If the approaching financial year isn't the first year that the approved remuneration policy is applied, then companies will need to highlight any significant changes in the way the policy will be implemented from the current financial year being reported on.

The statement must include performance measures and weightings, performance targets and how awards will be calculated, unless disclosed

elsewhere in the report. The disclosure of targets is subject to the opt-out for commercially sensitive information.

Consideration by directors of matters relating to directors' remuneration

Previous drafts of the regulations included a disclosure of total fees paid to the remuneration committee's advisors for other advice their firm provides to the business, beyond their advice to the remuneration committee. The regulations no longer include this requirement, but the fees for advice to the remuneration committee itself need to be disclosed.

Policy part now directors' remuneration policy

There is a general proviso to the directors' remuneration policy that, if the directors are able to exercise discretion on any element of the policy, the policy statement must explain the extent to which that discretion could apply to any variation, change or measurement within directors' remuneration policy.

Future policy table

For each element of remuneration, the future policy table must set out the minimum level of performance that will result in any payment and any further performance thresholds. If any element wasn't included in the previous policy, there should be a statement justifying its inclusion and for any elements that were previously included, details of any changes made and why.

For non-executive directors' fees, the policy table should set out the approach to the determination of each element of the fees and other items of remuneration.

Approach to recruitment remuneration

The statement of approach to recruitment remuneration no longer includes a requirement to set out the maximum level of salary which may be awarded. Instead, it must set out the maximum level of variable remuneration which may be granted, in monetary terms or otherwise. This doesn't include 'buy-out' awards to compensate an executive for the forfeit of an award from a previous employer.

Policy on payment for loss of office

BIS has recognised that the treatment of leavers at board level will usually involve an element of discretion. So, the regulations require disclosure of how the circumstances of the director's departure and performance during his period of office would be relevant to any exercise of discretion. It should also state whether any contractual provision agreed before the release of the first draft of the regulations (27 June 2012) could impact on the quantum of the payment.

South Africa – New Companies Act

The new Companies Act, 2008, introduces significant change in governance practices concerning among other things the appointment of the audit committee.

Audit committee

All public companies as well as state-owned companies (SOCs) must appoint an audit committee. Non-listed and other companies may appoint an audit committee if provided by its memorandum of incorporation (MOI).

For a public company that is listed on an exchange, both the Act and the relevant listing requirements (including King III governance principles), will apply concurrently to the extent that it is possible to do so without contravening either of them. To the extent that this is not possible, the Act will prevail.

In order to be properly constituted, the audit committee must be appointed by the shareholders at the annual general meeting (AGM). At each AGM the audit committee must be reappointed. The directors may not appoint the audit committee as was the case in the old Companies Act, which permitted the board of directors in addition to shareholders to appoint the audit committee.

The new Act has a limited application to companies that are subject to the Banks Act, 1993. In addition, a company that has been granted exemption under Section 64(4) of the Banks Act, is also exempted in terms of the Act.

The Act, however, permits the directors to reappoint a new member following a vacancy on the audit committee. This has to be within 40 days of the vacancy arising.

As was the case with the old Companies Act, the appointment of an audit committee is not necessary if the company is a subsidiary whose holding company has an audit committee, which performs the duties of the audit committee on behalf of the subsidiary.

The involvement of shareholders in the appointment of the audit committee emphasises the new focus on participation of shareholders in the governance and financial control of the company. King III observes that the role of the nomination committee has become increasingly important, as it is required to identify suitably skilled and qualified members of the board of directors for nomination to the audit committee.

Shareholders, however, still have the central power to appoint anyone they deem skilled and qualified to be a member of the audit committee. This appointment provides some oversight in terms of conflicts that may arise between the audit committee and the board of directors.

Each member of the audit committee must be a member of the board of directors and must meet the Minister of Trade and Industry's prescribed minimum qualification requirements. These require that one-third of members at any particular time have academic qualifications or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources management. Consequently, all individuals who do not qualify to serve as directors are precluded from serving on the audit committee. They are allowed to attend meetings, but will have no voting powers and will not be able to perform the duties of the audit committee.

The aim is to ensure that, taken as a whole, the audit committee is comprised of persons with adequate relevant knowledge and experience to perform the functions of the audit committee prescribed by the Act:

The audit committee is required to execute the following legislative duties:

- Nominate a registered auditor who is independent of the company to be appointed as auditor of the company. Section 94(8) gives detailed guidance regarding tasks the audit committee should conduct to determine the independence of the auditor;

- Nothing precludes the appointment of an auditor other than one nominated by the audit committee by a public company at its AGM. However, if an auditor not nominated by the audit committee is appointed, the appointment only becomes valid once the audit committee is satisfied that the proposed auditor is independent of the company;

- Determine the fees to be paid to the auditor and the auditor's terms of engagement;
- Ensure that the appointment of the auditor complies with the provisions of this Act and any other legislation;
- Determine the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company;
- Pre-approve any proposed agreement with the auditor for the provision of non audit services to the company;
- Prepare a report that:
  - Describes how the audit committee carried out its functions;
  - States whether the audit committee is satisfied that the auditor was independent of the company; and
  - To comment in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company.[12]
- Receive and deal appropriately with any concerns or complaints, whether from within or outside the company, or on its own initiative, relating to:
  - The accounting practices and internal audit of the company;
  - The content or auditing of the company's financial statements; and
  - The internal financial controls of the company or any related matter.
- Make submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting; and
- Perform other functions determined by the board.

[12] This report must be included in the annual financial statements (not with 'other information' as before).

11

The profile of a non-executive director

Introduction

South African stakeholders, including shareholders, look to non-executive directors to bring transformational change across a range of disciplines. Because every company is different, this requires directors to have more specialist knowledge than ever before. As the complexity of a globalised world speeds up change in every facet of business, the demands placed on non-executive directors will only increase.

Directors charged with stakeholder engagement are also feeling pressure created by social media and civic action. More voices clamouring in more outlets for more attention is changing how companies engage, why companies engage and with whom they engage.

Against this backdrop of increased responsibility and accountability, it may initially appear concerning that the number of non-executive directors serving on JSE-listed companies has decreased by 3.9% to 2 204 (2012: 2 294). However, during the same reporting period, the number of active entities listed on the JSE has reduced by a similar percentage. Included in this year's total count are 285 (2012: 293) chairpersons, 63 (2012: 73) deputy chairpersons and 116 (2012: 64) lead directors.

Gender diversity

Gender diversity is high on the agenda globally, including in the boardroom and there is pressure on companies to ensure they at least meet industry targets, if not achieve equal numbers of males and females on their boards.

Women holding executive posts

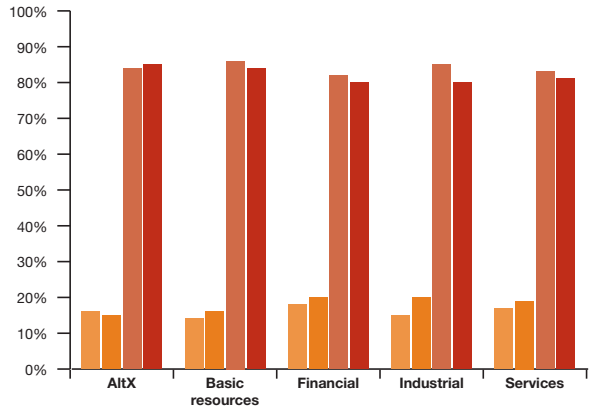
Region	Corporate boards
Latin America	7%
Asia	11%
Oceania	15%
Africa	16%
Europe	16%
North America	18%

Source: World Bank Enterprise Surveys 2011/2012; United Nations Department of Economic & Social Affairs 2011/2012 Trends & Statistics; PwC analysis

While progress has been slow, Nordic countries, in particular, are doing better than most. Norway's board representation is currently 25% and Sweden's 21%.

In South Africa there have been positive moves to engage more females in the boardroom, but as Figure 7 shows, there is still much room for improvement.

Figure 7 – Gender profile: Non-executive directors



	AltX	Basic resources	Financial	Industrial	Services
Female 2012	16%	14%	18%	15%	17%
Female 2013	15%	16%	20%	20%	19%
Male 2012	84%	86%	82%	85%	83%
Male 2013	85%	84%	80%	80%	81%

Source: PwC analysis

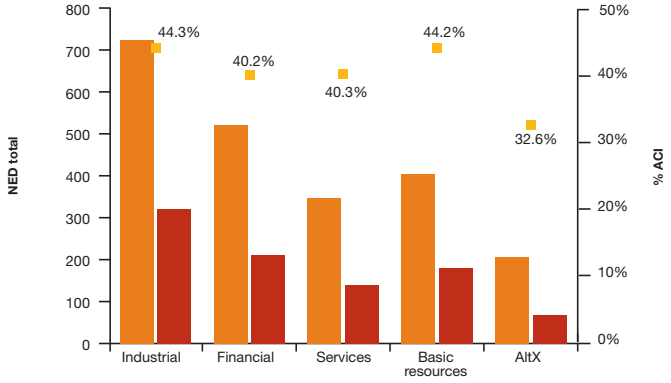
Racial transformation

As with gender diversity, South African boards also face the challenge of transforming to reflect the racial composition of our society

The amended BEE Codes of Good Practice was gazetted on 11 October 2013. Companies will be granted a one-year transitional period to align and prepare for the ultimate implementation of the new revised broad-based black empowerment (B-BBEE) code. According to the Department of Trade and Industry, the amended code is a 'new beginning' which aligns more closely to the Government's transformation ambitions.

The racial profile of boards for the 2013 reporting period is shown in Figure 8.

Figure 8 – African, Coloured and Indian (ACI) board representation by sector: Non-executive directors



	Industrial	Financial	Services	Basic resources	AltX
NED Total	724	522	347	404	207
ACI Representation	321	210	140	179	67
% ACI	44.3%	40.2%	40.3%	44.2%	32.6%

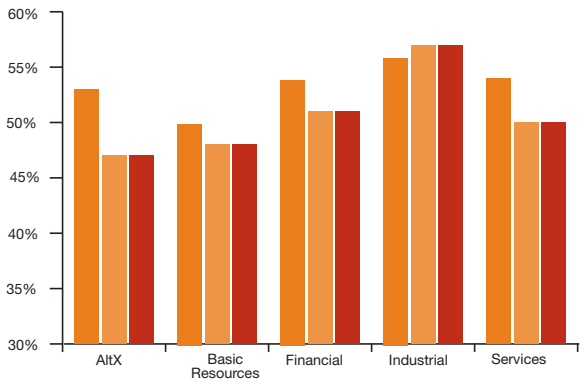
Source: PwC analysis

Independence

A non-executive director should be independent of the day-to-day operation of the company's business. However there is a contradiction between the requirements of the new Companies Act and King III, as non-executive directors must also have an intimate knowledge of the company and its business.

Independence in the boardrooms of JSE-listed companies for the 2013 reporting period is reflected in Figure 9.

Figure 9 – Independence status: Non-executive directors



	AltX	Basic Resources	Financial	Industrial	Services
2011	53%	50%	54%	56%	54%
2012	47%	48%	51%	57%	50%
2013	47%	48%	51%	57%	50%

Source: PwC analysis

Number of directorships

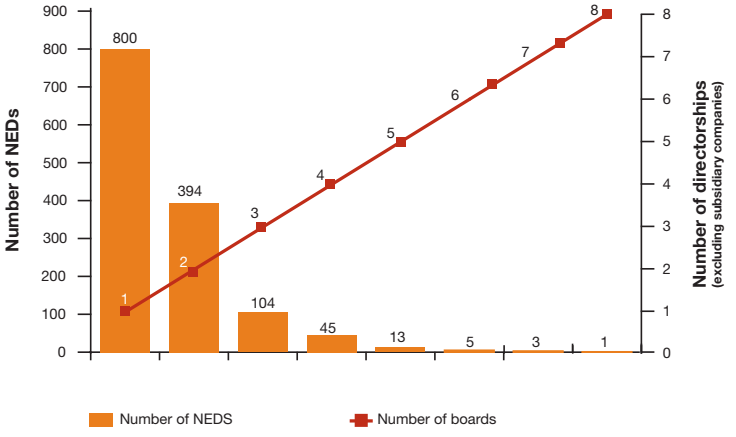
Meeting the responsibilities of a non-executive director requires not only skill, but also the allocation of sufficient time and attention for adequate preparation before meetings to ensure non-executive directors are making a meaningful contribution to the board.

Some of the non-executive directors sitting on multiple boards included in Figure 10 must find it difficult, if not impossible, to be fully prepared for the many meetings they have to attend. Not only does the annual general meeting require adequate preparation, but there are also committee meetings requiring similar if not greater levels of commitment.

It should be in these committees that the daily decisions regarding management and strategy are made and where the effectiveness and value of individual non-executive directors are measured.

When it comes to holding positions on multiple boards, there can be no doubt that a conflict arises between the time commitment required and the number of board positions an individual can hold effectively.

Figure 10 – Membership of multiple boards: Non-executive directors



Source: PwC analysis

In view of the fact that there are fewer non-executive directors in total, serving on multiple boards has become more frequent. This may be indicative of a shortage of non-executive directors in South Africa and may also reflect the reluctance of nomination committees to nominate inexperienced candidates to their boards.

Non-executive directors' domicile

Forty-two percent of the JSE's total market capitalisation is controlled by non-executive directors who are paid in foreign currency as directors on the boards of JSE-listed companies. Sixty-three percent of the total fees paid to non-executive directors are paid in foreign currency.[13] Overall, 13% of all non-executive directors of JSE-listed companies receive 63% of total fees paid.

The duties of a non-executive director are not confined to fixed hours of work and being resident would not be a requirement. Commuting to attend meetings may not be cost effective. A local director therefore has an immediate cost advantage to the company compared to a non-resident director.

Since directors domiciled overseas do not need to declare their residence status, it is difficult to pinpoint their domicile accurately using published annual financial statements as the source of information. We have applied the principle of determining domicile by examining identity registration in CIPC[14] filings, as well as any mention in the annual financial statements indicating domicile. South African citizens on the boards of dual listed companies are considered as South African domiciled, notwithstanding the practice of being paid in foreign currency.

Domicile of non-executive directors

Country of residence	2012	% of total	2013	% of total
South Africa	2 047	89.23%	1 935	87.79%
UK	62	2.70%	64	2.90%
Australia	53	2.30%	57	2.59%
USA	32	1.40%	31	1.41%
China	12	0.52%	22	1.00%
Germany	19	0.85%	20	0.91%
Nigeria	11	0.50%	10	0.45%
Italy	11	0.50%	9	0.41%
Namibia	8	0.33%	9	0.41%
Zimbabwe	6	0.28%	7	0.32%
Brazil	1	0.06%	7	0.32%
Canada	5	0.22%	5	0.23%
France	5	0.22%	5	0.23%
Botswana	4	0.17%	5	0.23%
Switzerland	5	0.20%	5	0.23%
Greece	5	0.22%	4	0.18%
Russia	-	-	3	0.14%
Japan	3	0.11%	3	0.14%
Netherlands	1	0.06%	1	0.05%
New Zealand	1	0.06%	1	0.05%
Spain	1	0.06%	1	0.05%
Total	**2 294**		**2 204**	

Source: PwC analysis

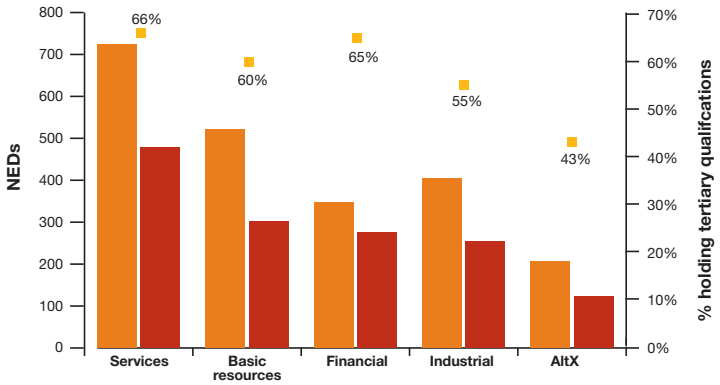
[13] Converted at spot foreign exchange rate at cut-off date.

[14] Companies and Intellectual Property Commission

Non-executive directors' qualifications

South Africa listed companies have a significant proportion of non-executive directors that hold various forms of higher education qualifications. Figure 11 provides an overview of education levels among non-executive directors of JSE-listed companies.

Figure 11 – University degree or similar tertiary education: Non-executive directors



	Services	Basic resources	Financial	Industrial	AltX
NEDs	724	522	347	404	207
Tertiary qualification	477	301	276	253	122
% with qualification	66%	60%	65%	55%	43%

Source: PwC analysis

Fees

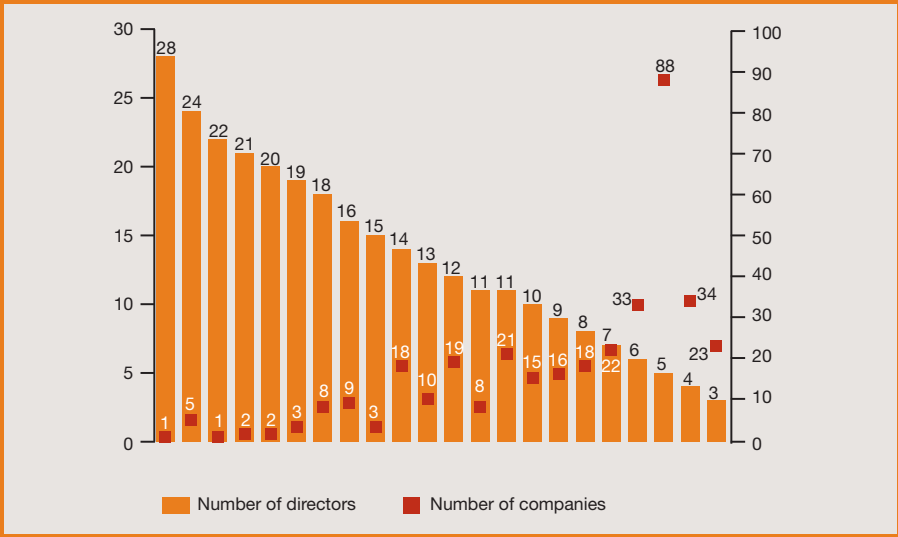
Principle 2.18 of the King III code calls for there to be a balance of power on boards with the majority of non-executive directors being independent. By default, the CEO and chairperson positions should be separate.

The nominations committee will assist with the identification and recommendation of potential members to the board of directors, but the task of choosing suitable candidates is very difficult.

Knowledge, skills, resources, diversity and the ability to apply these skills effectively is paramount to deal with modern-day challenges. For this reason, non-executive directors should be specialists rather than generalists with expertise specific to the company's on whose boards they serve.

Figure 12 illustrates the board size of JSE-listed companies.

Figure 12 – Number of directors on the board



Source: PwC analysis

All boards made up of 20 or more directors belong to large-cap companies. The remainder are a made up of large, medium and small-cap companies.

The complexity of a company often determines the size of its board of directors. The one company on the JSE that has 28 members on its board has a footprint in 33 countries, on five continents and revenue in excess of R134 billion. The diversity of the business encompasses more than 300 subsidiary companies and joint ventures, which increases the complexity of management and governance.

Many companies now have a footprint beyond the borders of South Africa and it is no small task to ensure that management in all sectors is following company strategy and the rule of law, both locally and in those foreign jurisdictions in which they operate. Given the scale and complexity of such demands once again raises the question of how non-executive directors can effectively give their attention to multiple boards.

Structure

In this publication, fees paid to non-executive directors is the aggregate of all fees paid to non-executive board members serving on all companies listed on the JSE.

The aggregate is made up of the following:

- Fee as a member of the main board; and
- Fees paid to serve on a board committee.

In some cases, a single fee is paid to a non-executive director regardless of the number of committees on which he or she may serve.

Fees paid to chairpersons are calculated in the same manner, but it is often the case that the chairperson receives a single fee as chairman of the board and is not paid for attending committee meetings.

Chairpersons of board committees are usually paid a premium committee fee, which may be double the fee paid to a committee member. There is no fast rule regarding the premium and this may vary depending on the committee.

There is no overall rule regarding fixed fees for committee members, but this is generally the practice. However, the fixed-fee rule does not always apply. For example, when committee meetings extend beyond the time allocated, directors may be paid a higher fee.

Our research shows that the number of non-resident non-executive directors serving on boards of JSE-listed companies increased to 269 (2012: 247) during the 2013 reporting period. It should be borne in mind that fees are paid to them in foreign currencies and then converted to South African rand. This makes it difficult to provide a meaningful analysis of the exact premium paid to non-residents directors.

Our initial research shows that non-resident board members earn a premium around 2.5 times that of their local counterparts. Similarly, for non-resident committee members, the premium is significantly higher around 3.5 to 3.8 times that of their local counterparts.

In this publication we measure total fees paid to reflect the trend in 2013 against a time series of three years.

Analysis

Fees paid to chairpersons and non-executive directors of companies listed on the JSE have been analysed by sector. As mentioned previously reported, sectors are classified as follows:

- Financial services;
- Basic resources;
- Services;
- Industrials; and
- AltX.

Each sector is analysed with reference to market capitalisation as follows:

- Large – ranked as the top 40 companies;
- Medium – companies ranked between 41 and 100;
- Small – companies ranked 101 and below.

Meetings

The size of committees varies substantially between different companies due to the varying nature of their business activities and the challenges they face.

Although there are ad-hoc committee meetings held, which may have a descriptive title, meetings held are classified into these categories:

- Board meeting;
- Audit committee;
- Corporate governance;
- Nominations;
- Remuneration;
- Risk; and
- Sustainability.

Some committee meetings are held in combined session. These have been isolated from the combination and reflected as a tabled meeting.

	Board			Audit			Corporate governance			Nominations		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
AltX	3	4	4	4	3	6	2	3	3	4	4	4
Automobiles & parts	4	5	4	2	2	3	2	3	3	6	5	5
Banking	7	7	7	5	4	5	5	5	5	6	4	4
Base metal processing	5	6	6	2	3	3	2	2	2	4	4	4
Chemicals	3	3	3	2	3	6	5	4	4	4	4	2
Construction & materials	6	6	7	2	3	5	5	4	4	3	4	4
Development capital	2	3	2	3	3	3	4	4	4	2	2	2
Financial services	6	6	5	5	5	6	5	4	4	6	4	4
Food	4	5	5	3	4	5	6	5	5	4	4	4
Healthcare	5	6	6	5	4	6	2	2	2	6	5	5
Industrial goods & services	3	3	4	2	3	5	2	3	3	4	3	3
Insurance	7	7	6	3	3	5	2	3	3	4	3	3
Investment instruments	4	4	5	4	5	5	6	5	5	1	2	2
Media	4	4	4	2	2	3	5	4	4	1	2	2
Metal trading	4	5	4	2	3	6	5	4	4	6	4	1
Mining	5	5	5	4	4	6	4	3	3	6	4	4
Oil & gas	4	4	4	2	3	4	3	3	3	5	4	4
Personal & household goods	5	6	5	2	3	6	5	5	5	2	3	3
Retail	5	5	6	5	4	6	5	4	4	4	4	4
Technology	4	4	5	5	5	5	2	2	2	2	3	3
Telecommunication	4	5	5	5	6	5	4	4	4	3	3	3
Travel & leisure	4	5	4	2	3	4	3	3	3	6	4	4
Venture capital	3	3	3	3	4	3	4	3	3	6	5	5
Average	4	5	5	3	3	5	4	3	3	4	3	3

Source: PwC analysis

Other			Remuneration			Risk			Sustainability			Aggregate all meetings		
2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
4	4	2	4	4	4	3	3	3	5	6	6	28	29	29
2	5	5	4	3	3	6	6	6	6	4	4	32	32	32
2	2	2	2	3	3	6	6	6	4	4	5	29	33	33
2	3	3	3	3	3	6	6	6	4	5	5	35	32	32
3	3	3	2	3	3	5	4	4	4	6	6	29	29	29
7	7	7	3	4	4	7	7	7	4	4	7	36	37	37
6	5	5	2	2	2	5	6	6	6	6	6	27	29	29
4	6	6	4	4	4	4	5	5	3	5	5	36	37	37
6	5	5	4	4	4	6	7	7	5	6	5	36	37	37
6	5	6	3	3	3	5	4	4	6	6	5	29	34	34
3	4	4	2	2	2	4	6	6	6	7	7	32	29	29
2	3	3	2	2	2	7	6	6	4	5	5	29	30	30
2	4	4	4	4	4	6	5	5	3	4	4	31	31	31
2	4	4	4	4	4	5	4	4	5	6	5	31	30	30
6	5	5	2	3	3	5	4	4	3	3	3	26	30	30
6	7	3	4	3	3	3	3	3	4	4	4	36	33	33
5	5	5	3	3	3	5	6	6	6	5	4	27	30	30
6	6	6	3	3	3	3	4	4	5	6	5	35	33	33
3	4	4	4	3	3	6	7	7	5	5	7	31	34	34
4	4	4	2	2	2	4	4	4	6	6	6	29	29	29
6	6	6	3	3	3	5	4	4	4	6	6	35	35	35
7	7	4	2	3	3	7	5	5	5	4	3	29	33	33
7	7	7	3	3	3	5	6	6	5	6	6	35	36	36
4	5	4	3	3	3	5	5	5	5	5	5	31	32	32

The average number of meetings held during the past three consecutive years is the same, although there are slight variances in meeting types.

Ratio of executive to non-executives

While the overall ratio of executive directors to non-executive directors (30%:70%) is in line with global benchmarks, there is some variation across sectors with basic resources showing the highest proportion of non-executive (82%) and AltX the highest proportion of executive directors (51%).

Ratio of executive to non-executives

Sector	Executive directors	Non-executive directors
AltX	51%	49%
Basic resources	18%	82%
Financial services	23%	77%
Industrial	30%	70%
Services	28%	72%
All sectors	30%	70%

Source: PwC analysis

13

Chairpersons' fees

Overall

Board chairpersons are paid a premium for their services. This position should be awarded to the person considered to be the most capable member serving on the board of directors. The chairperson should be independent and have the following special duties:[15]

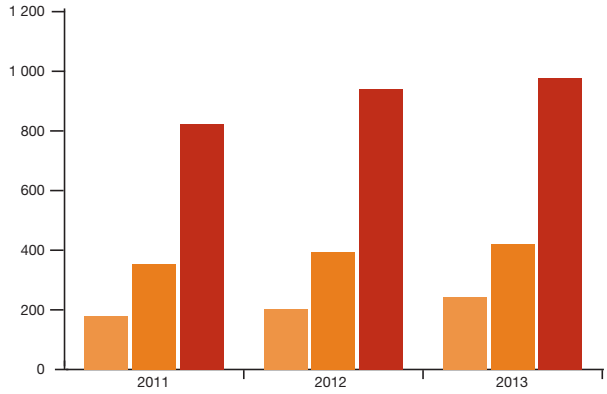
- Be responsible for the effectiveness of the board;
- Chair the nominations committee so as to influence the selection of an appropriately balanced board;
- Develop a relationship of trust with the CEO, recognising that they play different roles;

[15] Evolving chairs –the changing role of the chairman: Professor Mervyn King http:mervynking.co.za/nres/archives/11_01_evolving_chairs.htm [accessed 01 December 2013]

- Settle the agendas for board meetings, ensuring the focus is on key issues, generally of a longer-term nature;
- Ensure that the board makes meaningful input into the strategy of the company and that it settles the strategy; and
- Chair meetings of the board, which should reflect a balance between creative tension and collegiality.

For this key role, the remuneration trends for chairpersons serving on the boards of JSE-listed companies are shown in Figure 13.

Figure 13 – Remuneration of chairpersons: All sectors (R'000s)



	2011	2012	2013
Lower quartile	179	203	242
Median	354	394	422
Upper quartile	822	941	979

Source: PwC analysis

The median increase awarded to chairpersons overall in 2013 is 7.1% (2012: 11.3%), which is slightly above the 2013 estimated inflation rate for South Africa. The increase at the upper quartile was 4.0%. This saw the overall fees increase at the median level from R394 000 to R422 000.

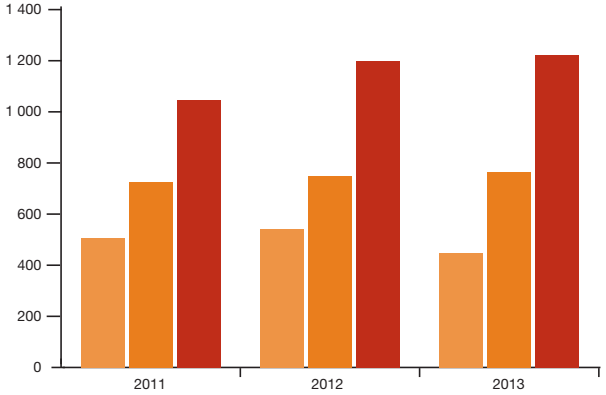
Considering the trend of rising costs and the shortage of skilled people in the country a premium will probably be paid to fill future vacancies.

Deputy chairpersons & lead independent directors

The deputy chairperson is usually appointed to support the chairperson in the event that latter is not independent. This appointment will be supportive where there may be a conflict of interest on major decisions.

Deputy chairpersons are mostly appointed to the boards of larger companies, hence the disparity between their fees and fees paid to chairpersons for all sectors.

Figure 14 – Remuneration of deputy chairpersons: All sectors (R'000s)



	2011	2012	2013
Lower quartile	508	542	448
Median	724	748	763
Upper quartile	1 047	1 200	1 221

Source: PwC analysis

The increase awarded to deputy chairpersons in 2013 at the median level is 2.0% (2012: 3.3%), which is well below inflation. This saw the fees increase at the median level from R748 000 to R763 000.

A lead independent director (LID) may also serve a similar function to that of the deputy chairperson, but more importantly can add value to board composition by bringing directorship experience to the table. A close examination of this position shows that smaller companies that may lack business experience, appoint an LID for board guidance, especially when major decisions are to be made.

Lead independent directors are fulfilling this vital role in many countries. For example, in Singapore their presence is called on in the following circumstances: [16]

- Where the chairman and the CEO is the same person;
- Where the chairman and the CEO are related by close family ties; and
- Where the chairman and the CEO are both members of the executive management team.

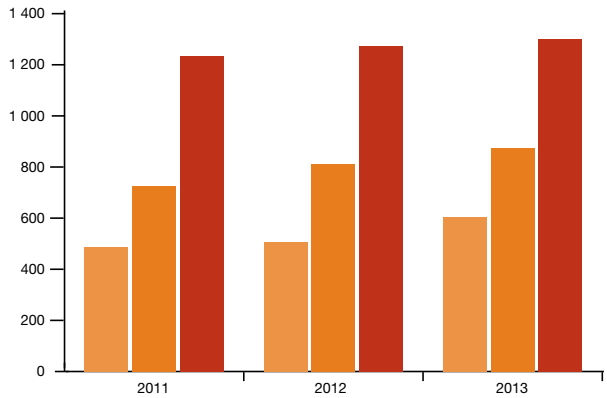
The last point is of particular significance in South Africa where until now no LID has been appointed to referee important decisions when these parties' independence is conflicted.

16 Singapore Institute of Directors: Statement of good practice SGP No.7/2007

Singapore also requires that an LID perform a more enhanced function than an independent director by:

- Leading the independent directors at board meetings in raising queries and pursuing matters; and
- Leading meetings of independent directors without the presence of the executive directors.

Figure 15 – Remuneration of lead independent directors: All sectors (R'000s)



	2011	2012	2013
Lower quartile	489	507	604
Median	727	811	876
Upper quartile	1 235	1 275	1 302

Source: PwC analysis

In South Africa, the level of fees paid to a LID is relatively low in comparison to that paid to those in that position in other countries.

The median increase in 2013 was above inflation at 8.0% (2012: 11.6%), which follows the historic trend in 2012. This saw the fees increase at the median level from R811 000 to R876 000.

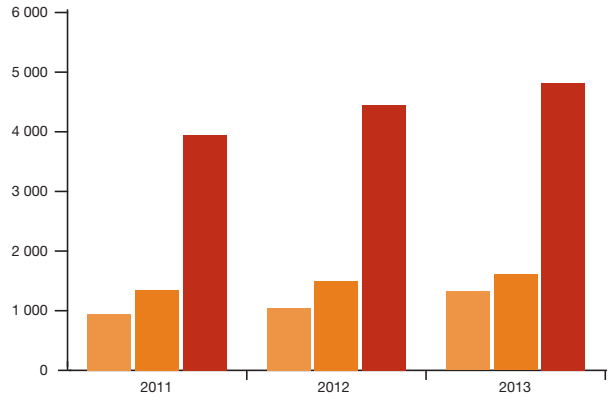
Financial services

The financial services sector makes up 24% of the companies listed on the JSE. The sector is made up of a broad range of organisations that manage money, including banks, credit card companies, insurance companies, finance companies, real estate companies and stock brokerages.

Although uncertainty surrounding the recent debt crisis persists, the financial services industry in South Africa has remained reasonably stable and profitable.

A high level of regulation and supervision is in place in the sector, yet the upward trend in fees paid to chairpersons persists. In all fairness, the chairperson at the helm of a financial services company has the added task of being ultimately responsible for other people's money. In addition, companies in this sector have many investors who depend on careful control of their money and a consistent return on the investment.

Figure 16 – Remuneration of chairpersons: Large-cap financial services (R'000s)

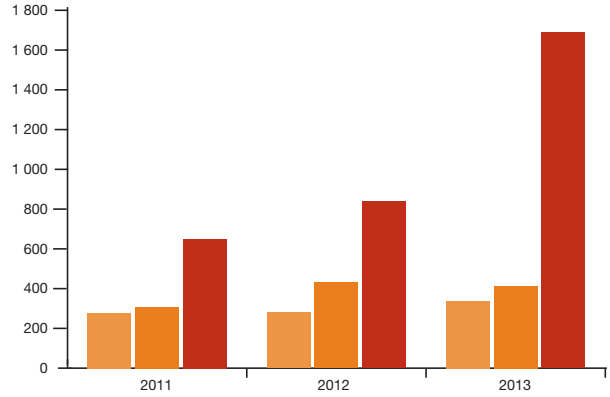


	2011	2012	2013
Lower quartile	942	1 043	1 321
Median	1 347	1 502	1 608
Upper quartile	3 947	4 452	4 816

Source: PwC analysis

The large-cap section in this sector awarded a 7.1% (2012: 11.5%) increase in total fees at the median level, slightly above the inflation rate. This saw the fees increase at the median level from R1 502 000 to R1 608 000.

Figure 17 – Remuneration of chairpersons: Medium-cap financial services (R'000s)

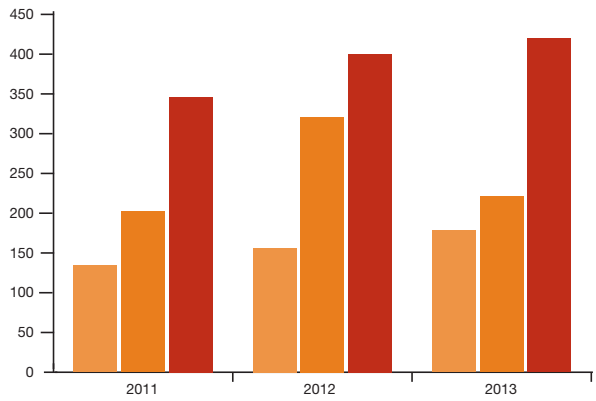


	2011	2012	2013
Lower quartile	278	281	338
Median	307	432	413
Upper quartile	649	837	1 689

Source: PwC analysis

Chairpersons in medium-cap financial services companies received an increase in excess of 100% at the upper quartile, but at the median level there was an overall decrease of 4.4% (2012: +40.7%).An examination of the data reflects that chairpersons here have been upgraded both in terms of the basic fee paid as chairperson and higher fees paid for their membership of board committees. This saw the fees decrease at the median level from R432 000 to R413 000.

Figure 18 – Remuneration of chairpersons: Small-cap financial services (R'000s)



	2011	2012	2013
Lower quartile	134	156	178
Median	202	321	221
Upper quartile	346	400	420

Source: PwC analysis

Similar to the medium-cap, the upper quartile fared well, but at the median level there is a decrease of 31.2 % (2012: +58.9%). The main reason for this decrease is that in many cases such as the real estate investment trusts, the chairperson's position has been assumed by the CEO. This saw the fees decrease at the median level from R321 000 to R221 000.

Basic resources

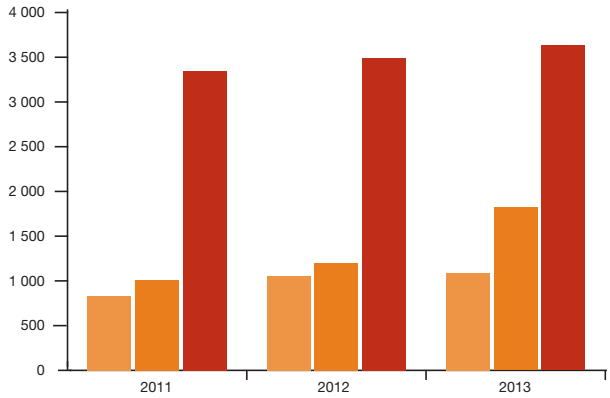
This sector accounts for companies involved in the discovery, development and processing of raw materials, including mining and refining of metals, as well as products derived from forestry.

The risk profile in the basic resources sector is cause for concern, especially because rising production costs and labour problems in the mining sector. The forestry sector is also not immune to labour unrest, as it is closely linked to the agricultural sector, which is where it draws its labour.

The main drivers in this sector are of course market prices and demand for commodities.

The large-cap median fees paid increased by 51.4% (2012: 18.8%). In this sector a number of companies pay their directors in foreign currency. The value of the rand has depreciated significantly, contributing to the increase in the rand value of the fees paid to non-executive directors. This saw the fees increase at the median level from R1 202 000 to R1 820 000.

Figure 19 – Remuneration of chairpersons: Large-cap basic resources (R'000s)

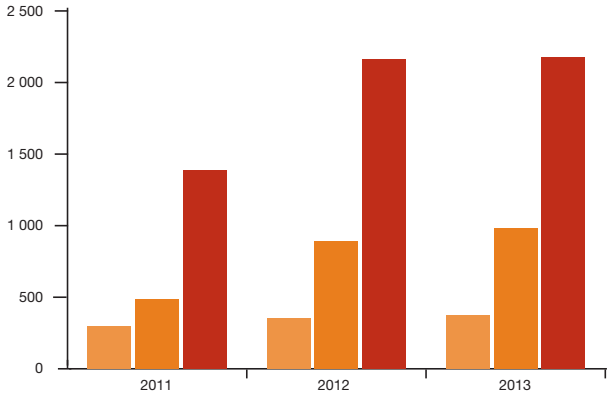


	2011	2012	2013
Lower quartile	833	1 056	1 089
Median	1 012	1 202	1 820
Upper quartile	3 348	3 493	3 623

Source: PwC analysis

The medium-cap companies reflect an increase of 10.4% (2012: 83.9%) at the median level. This saw fees at the median level increase from R890 000 to R983 000, resulting in fees doubling over a two-year period.

Figure 20 – Remuneration of chairpersons: Medium-cap basic resources (R'000s)

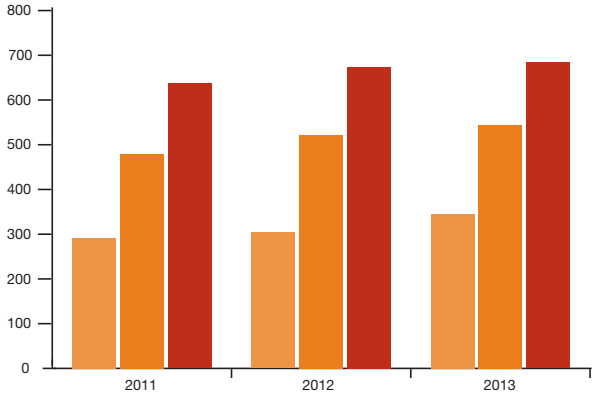


	2011	2012	2013
Lower quartile	297	352	375
Median	484	890	983
Upper quartile	1 388	2 164	2 175

Source: PwC analysis

Median level increases for small-cap companies was a modest 4.4% (2012: 8.9%), which saw fees increase at the median level from R521 000 to R544 000.

Figure 21 – Remuneration of chairpersons: Small-cap basic resources (R'000s)



	2011	2012	2013
Lower quartile	292	304	346
Median	479	521	544
Upper quartile	637	674	684

Source: PwC analysis

Services

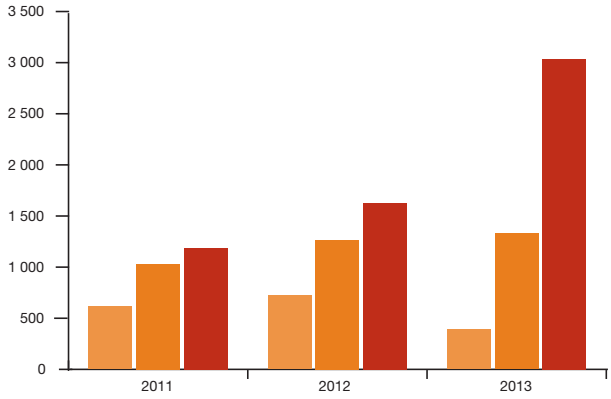
All companies involved in services to business and the public are included in this section. Five main headings are included namely:

- Healthcare
- Media
- Retail
- Support services
- Travel & leisure

This sector represents 17% of the total current count of listed companies on the JSE.

Notwithstanding inflationary pressures, this sector is showing growth since escalating costs are easily passed along to consumers. The retail industry is at particular risk since it has more customers than any other industry. Every customer in this market has the right to voice their opinion publicly and directors will find it difficult to ignore issues that have been raised.

Figure 22 – Remuneration of chairpersons: Large-cap services (R'000s)



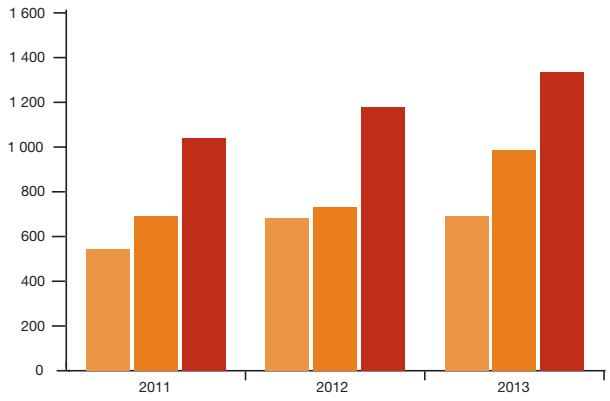
	2011	2012	2013
Lower quartile	616	722	390
Median	1 033	1 266	1 330
Upper quartile	1 189	1 624	3 034

Source: PwC analysis

The analysis reflects 5.1% (2012: 22.6%) increase in fees paid at the median level, while the increase at the upper quartile is a staggering 86.8%. At the lower quartile there was a decrease of 45.9%. This saw the fees increase at the median level from R1 266 000 to R1 330 000.

Medium-sized companies followed a similar trend with an increase of 35.2% (2012: 5.7%) 8.8% at the median level, which saw fees increase from R730 000 to R987 000.

Figure 23 – Remuneration of chairpersons: Medium-cap services (R'000s)

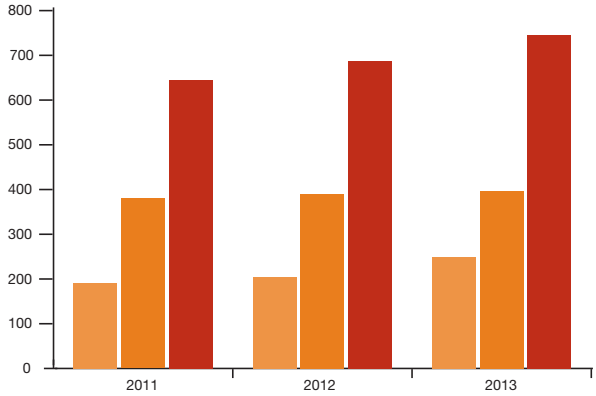


	2011	2012	2013
Lower quartile	544	680	692
Median	691	730	987
Upper quartile	1 041	1 180	1 335

Source: PwC analysis

The smaller companies in the sector did not move with the trend seen among the larger companies.

Figure 24 – Remuneration of chairpersons: Small-cap services (R'000s)



	2011	2012	2013
Lower quartile	191	205	249
Median	380	390	397
Upper quartile	644	687	745

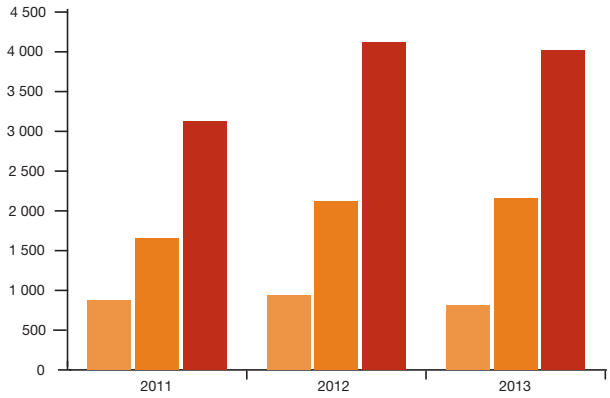
Source: PwC analysis

At the median level, the increase was limited to 1.8% (2012: 2.6%) for the chairpersons. This saw fees increase at the median level from R390 000 to R397 000.

Industrials

Companies included in this sector range from chemicals, construction and materials, engineering and manufacturing, oil and oil production to manufacture of household products, food manufacture and farming, personal goods manufacturing and distribution and technology. Industrials account for 29% by number of companies listed on the JSE and included in our analysis.

Figure 25 – Remuneration of chairpersons: Large-cap industrials (R'000s)



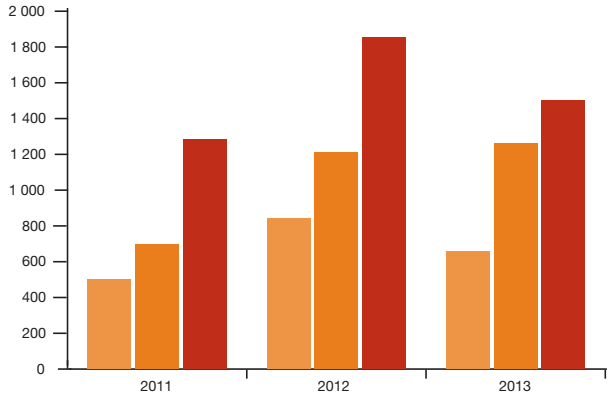
	2011	2012	2013
Lower quartile	871	942	817
Median	1 653	2 122	2 155
Upper quartile	3 127	4 113	4 019

Source: PwC analysis

At all breakpoints there were marginal increases or decreases. At the median level, the increase was limited to 1.6% (2012: 28.4%) for chairpersons. This saw fees increase at the median level from R2 122 000 to R2 155 000.

Medium-sized companies fared no better with a lower-than-inflation increase of 4.0% (2012: 73.6%) in total fees paid at the median level and decreases at both other quartiles, notably a 19.0% drop in the upper quartile. This saw the fees increase at the median level from R1 210 000 to R1 259 000.

Figure 26 – Remuneration of chairpersons: Medium-cap industrials (R'000s)

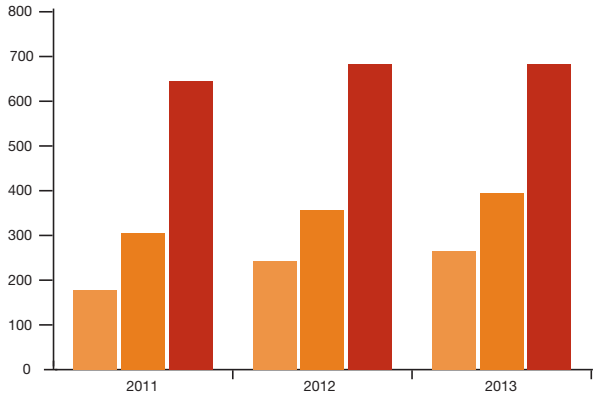


	2011	2012	2013
Lower quartile	501	842	656
Median	697	1 210	1 259
Upper quartile	1 281	1 854	1 502

Source: PwC analysis

The smaller companies in the sector fared better with above-inflationary increases at the median level of 10.7% (2012: 16.7%). This saw fees increase at the median level from R356 000 to R394 000.

Figure 27 – Remuneration of chairpersons: Small-cap industrials (R'000s)



	2011	2012	2013
Lower quartile	177	242	266
Median	305	356	394
Upper quartile	645	684	683

Source: PwC analysis

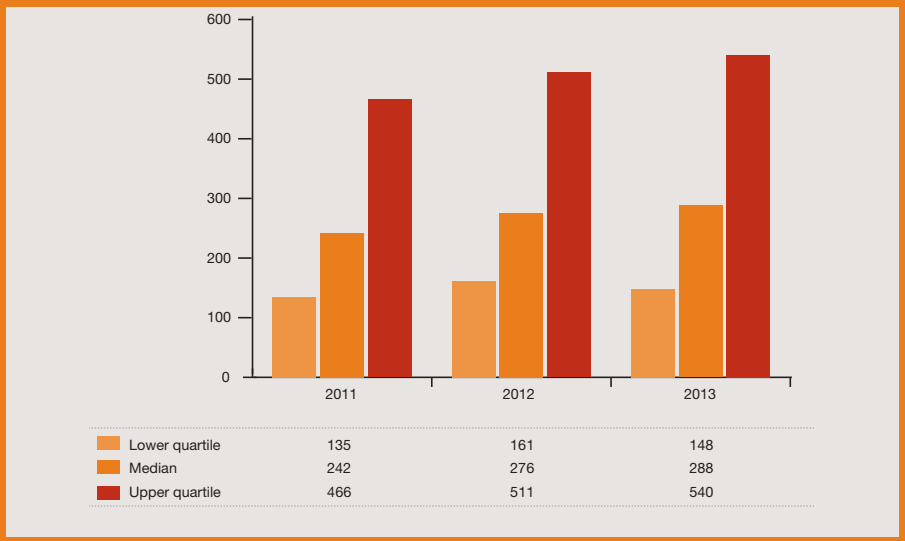

ROCKY MOUNTAIN

Non-executive directors' fees

Non-executive directors face the same risk challenges as chairpersons and executive directors. Generally speaking, the fees paid to non-executive directors are not commensurate with their risk level. They are held equally responsible in the eyes of the law regarding responsibility, which will by default shrink the available pool of talent, since it is an onerous task to face the same risky challenges without commensurate reward.

The increase at median level for all non-executive directors serving on the boards of all companies on the JSE was below the inflation rate at 4.3% (2012: 14.0%). This saw overall fees increase at the median level from R276 000 to R288 000.

Figure 28 – Remuneration of non-executive directors: All sectors (R'000s)



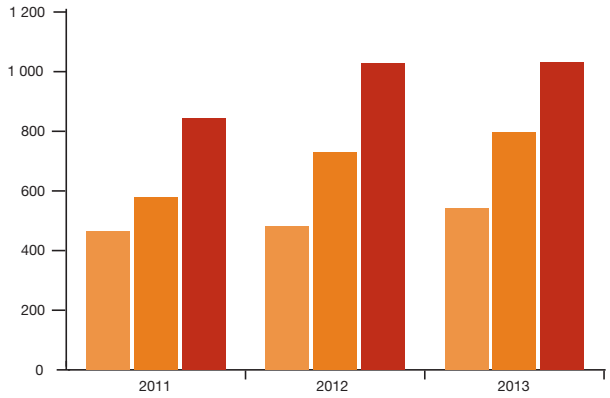
Source: PwC analysis

In 2012 we observed double-digit increases in non-executive director fees, but this has not continued through to the 2013 reporting period where some restraint has been shown with increases at the median level averaging 4.3%.

Financial services

Total fees paid to non-executive directors increased by 9.3% (2012: 26.2%). This saw overall fees increase at the median level from R728 000 to R795 000.

Figure 29 – Remuneration of non-executive directors: Large-cap financial services (R'000s)



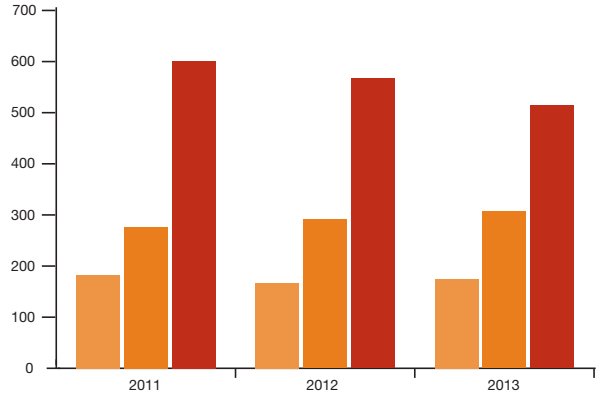
	2011	2012	2013
Lower quartile	466	482	541
Median	577	728	795
Upper quartile	845	1 027	1 030

Source: PwC analysis

In our experience, non-executive directors in South Africa are still relatively low paid in comparison to global norms for those holding similar positions in the financial industry,

Moving to medium-cap companies, we see that fees for the upper quartile have continued to decline, while the increase at median level is almost exactly in line with inflation at 5.5%.

Figure 30 – Remuneration of non-executive directors: Medium-cap financial services (R'000s)



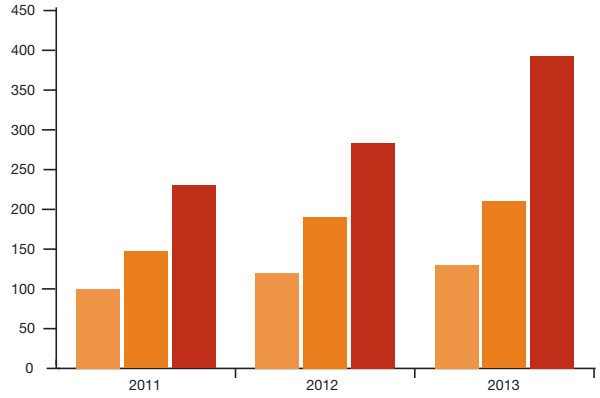
	2011	2012	2013
Lower quartile	183	167	175
Median	276	291	307
Upper quartile	601	567	514

Source: PwC analysis

The increase at median level is almost exactly in line with inflation at 5.5% (2012: 5.4%). This saw overall fees increase at the median level from R291 000 to R307 000.

The small-cap financial services companies show a higher growth trajectory with a median increase of 10.8% (2012: 28.9%), albeit at a lower level of total fees paid. This saw overall fees increase at the median level from R190 000 to R210 000.

Figure 31 – Remuneration of non-executive directors: Small-cap financial services (R'000s)



	2011	2012	2013
Lower quartile	100	120	130
Median	147	190	210
Upper quartile	230	283	393

Source: PwC analysis

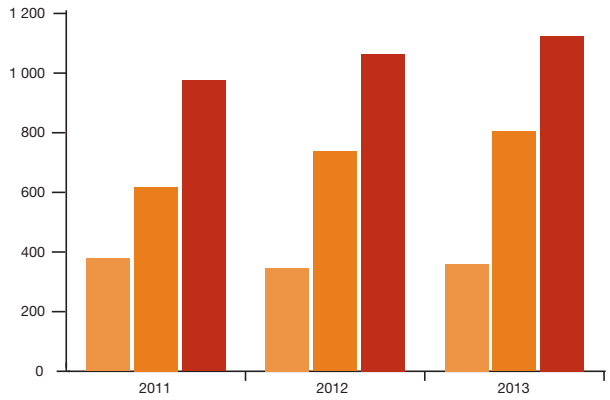
Basic resources

With lower demand from China and other global trading partners for raw materials, greater pressure will be applied on cost reduction in an industry that is facing labour problems, demands for higher wages and increased production costs.

Financial viability in mining is heavily dependent on the working cost of capital and the pressures mentioned increases the difficulty of keeping these at acceptable levels and delivering worthwhile returns on the investment.

Fee increases last year in the sector were moderate, particularly when one considers that specialisation is a requirement for non-executive directors in this complex industry.

Figure 32 – Remuneration of non-executive directors: Large-cap basic resources (R'000s)



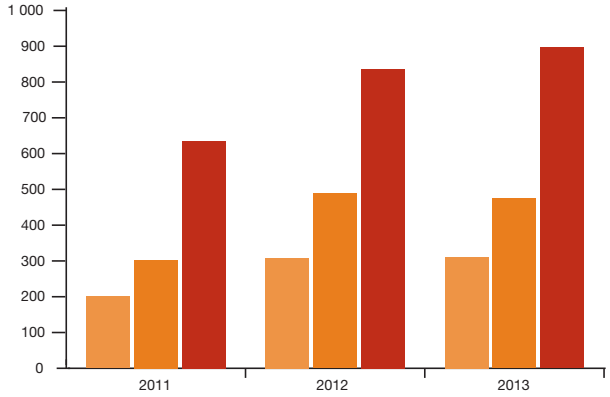
	2011	2012	2013
Lower quartile	378	347	359
Median	619	737	804
Upper quartile	975	1 064	1 125

Source: PwC analysis

The median increase awarded to non-executive directors in large-cap basic resources companies is 9.1% (2012: 19.1%), which is similar to the increase seen in large financial services companies. This saw overall fees increase at the median level from R737 000 to R804 000.

The medium-cap basic resources companies were relatively static with a decrease at the median level of 2.9% (2012: +61.4%). This saw overall fees decrease at the median level from R489 000 to R475 000.

Figure 33 – Remuneration of non-executive directors: Medium-cap basic resources (R'000s)

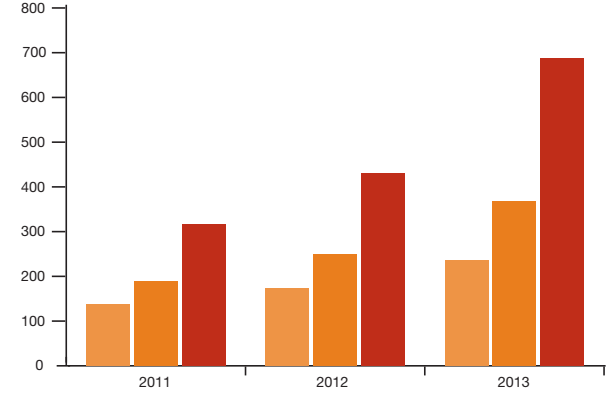


	2011	2012	2013
Lower quartile	201	309	311
Median	303	489	475
Upper quartile	635	837	89

Source: PwC analysis

Non-executive directors of small-cap companies received a significant increase at the median level of 48.1% (2012: 31.5%). This saw overall fees increase at the median level from R249 000 to R368 000, which is almost double where they were in 2011.

Figure 34 – Remuneration of non-executive directors: Small-cap basic resources (R'000s)



	2011	2012	2013
Lower quartile	138	174	235
Median	189	249	368
Upper quartile	317	431	688

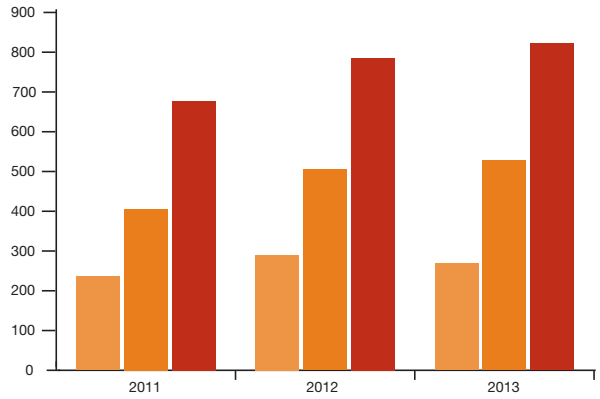
Source: PwC analysis

Services

Companies in the services sector are tenaciously fighting inflationary pressures arising mostly from non-trading areas such as labour, fuel and energy costs and in some cases customer demands.

Since the largest group of stakeholders in this sector are customers who pay for goods and services, the level of stakeholder engagement needs to be at a much higher level than in any other industry.

Figure 35 – Remuneration of non-executive directors: Large-cap services (R'000s)



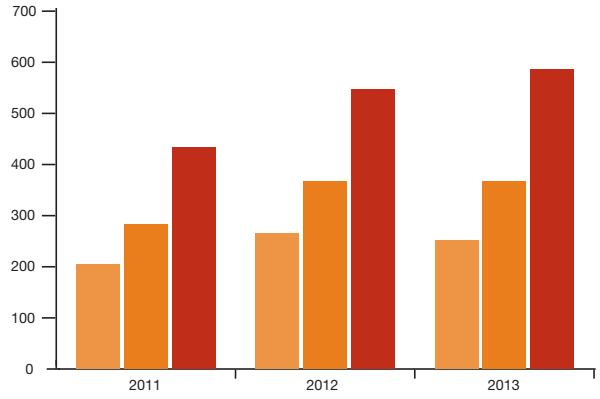
	2011	2012	2013
Lower quartile	236	290	269
Median	405	505	528
Upper quartile	677	785	822

Source: PwC analysis

The increase at median level was slightly below inflationary expectations at 4.6% (2012: 24.7%). This saw the overall fees increase at the median level from R505 000 to R528 000.

Fees for non-executive directors in medium-sized companies were also relatively static, showing an increase of just 0.3% (2012: 30.0%). This saw overall fees at the median level remain unchanged at R367 000.

Figure 36 – Remuneration of non-executive directors: Medium-cap services (R'000s)

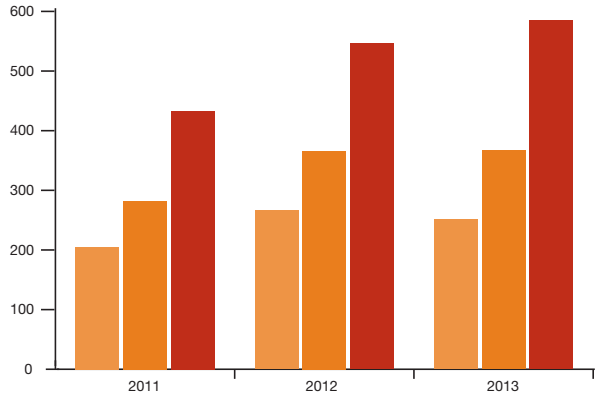


	2011	2012	2013
Lower quartile	205	266	251
Median	282	366	367
Upper quartile	433	546	585

Source: PwC analysis

Small-cap companies in this sector fared much better with significant increases at all levels and a 46.1% (2012: 16.9%) increase at the median level, albeit at a much lower level of fees. This saw overall fees increase at the median level from R194 000 to R284 000.

Figure 37 – Remuneration of non-executive directors: Small-cap services (R'000s)



	2011	2012	2013
Lower quartile	104	100	164
Median	166	194	284
Upper quartile	250	283	488

Source: PwC analysis

Industrials

While the Government's National Development Plan envisions ambitious goals for the future, currently the industrial sector is facing significant challenges to improving growth and capacity.

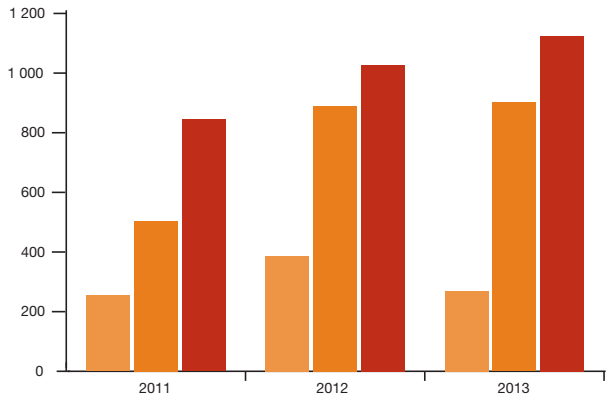
There is very little protection for South African industry and these challenges are being further exacerbated by competition from suppliers from Asia, other BRICS partners and the European Union.

Directors in this sector are under tremendous pressure and the quality of leadership in the boardroom will undoubtedly require a greater contribution from non-executive directors.

Between 2011 and 2012 there was a considerable increase in fees paid to "non-executive" directors of many large-cap companies. So it is perhaps not surprising that in 2013, large-cap companies at the median level increased total "non-executive" directors' fees by only 1.3% (2012: 76.0%).

The medium-cap and small-cap companies have already increased the level of fees paid to non-executive directors by a wide margin. This saw overall fees increase at the median level from R889 000 to R901 000, almost double what they were in 2011.

Figure 38 – Remuneration of non-executive directors: Large-cap industrials (R'000s)

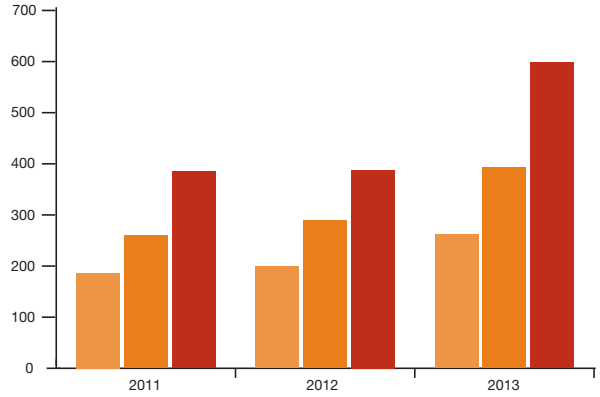


	2011	2012	2013
Lower quartile	254	387	269
Median	505	889	901
Upper quartile	844	1 027	1 125

Source: PwC analysis

Medium-sized industrial companies listed on the JSE have increased total fees paid to non-executive directors by 36.0% (2012: 11.2%). The upper quartile shows a similar trend. This saw overall fees increase at the median level from R289 000 to R393 000.

Figure 39 – Remuneration of non-executive directors: Medium-cap industrials (R'000s)

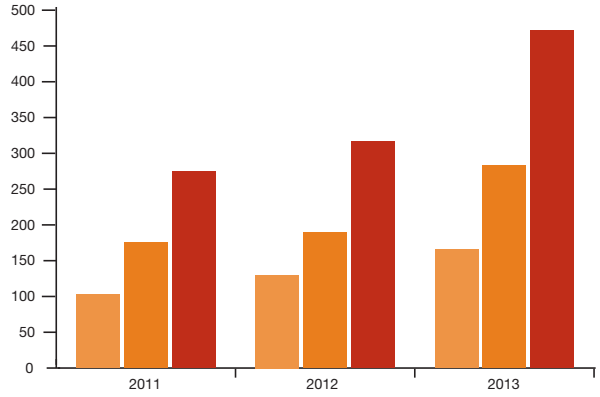


	2011	2012	2013
Lower quartile	186	199	262
Median	260	289	393
Upper quartile	385	388	598

Source: PwC analysis

Small-cap companies face the same risks as others in the sector and it would appear that these companies have taken the steps to populate their boards with well-paid non-executive directors.

Figure 40 – Remuneration of non-executive directors: small-cap industrials (R'000s)



	2011	2012	2013
Lower quartile	103	130	166
Median	175	189	283
Upper quartile	275	316	472

Source: PwC analysis

At the median level, total fees paid to non-executive directors increased by 49.7% (2012: 8.0%) in 2013. This saw overall fees increase at the median level from R189 000 to R283 000.

Here again, all three breakpoints reflect the same pattern and total fees have escalated to a more attractive level.

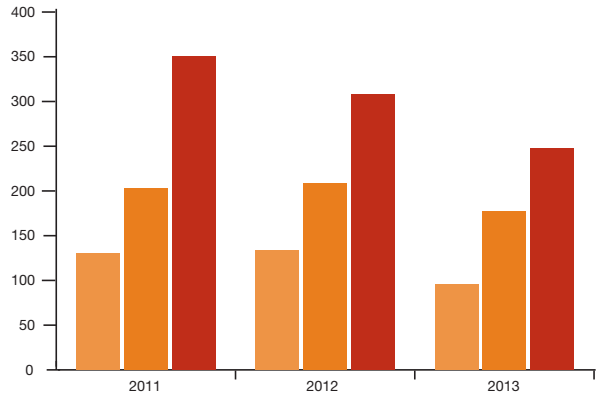
AltX companies

AltX, the alternative exchange, was established by the JSE to provide smaller companies not yet able to list on the JSE Main Board with a clear growth path and access to capital. As with larger companies, the shortage of directors qualified to govern AltX companies is a major challenge. The position in some AltX companies is further complicated by the fact that directors may also be founders of the business and thus reluctant to take advice from outsiders.

Chairpersons

While the median total fees paid to chairpersons in this sector did not increase in previous years, between 2012 and 2013 fee levels decreased substantially. This was most apparent in the lower quartile, which experienced a 39.5% decline.

Figure 41 – Remuneration of chairpersons: AltX (R'000s)



	2011	2012	2013
Lower quartile	130	134	96
Median	203	209	177
Upper quartile	350	308	248

Source: PwC analysis

It is not uncommon for the chief executive officer also to act as chairperson in AltX companies they have not be included in the benchmark reflected in Figure 41.

At the median level, there was a decrease of 15.3% (2012: +3.0%) in total fees paid. Further investigation suggests that in some instances, a family member of the founders of the company may act as chairperson at a nominal fee.

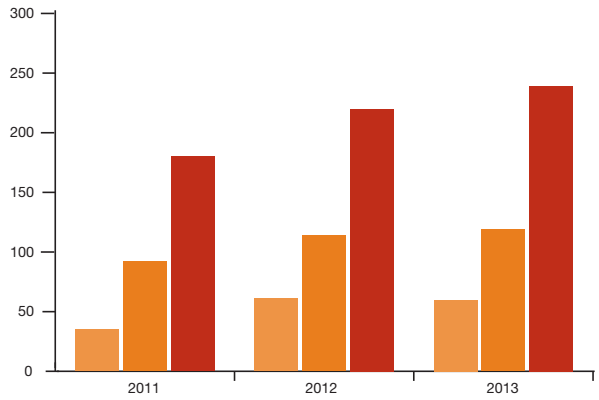
Such a practice would compromise the independence of the position of the chairperson, which goes against the spirit and purpose of the King III code of corporate governance. Should the aim be to progress to the JSE Main Board, AltX companies would be well advised to assemble a qualified and able board sooner rather than later.

Non-executive directors

A similar position exists for AltX non-executive directors in the boardroom where often that incumbent is a family member or close friend of other directors. This does not make for a robust or independent board and while it may appear to satisfy regulatory requirements, this too contradicts the foundational philosophy of King III.

Median level increases for non-executive directors were 4.4% (2012: 23.9%).

Figure 42 – Remuneration of non-executive director: AltX (R'000s)



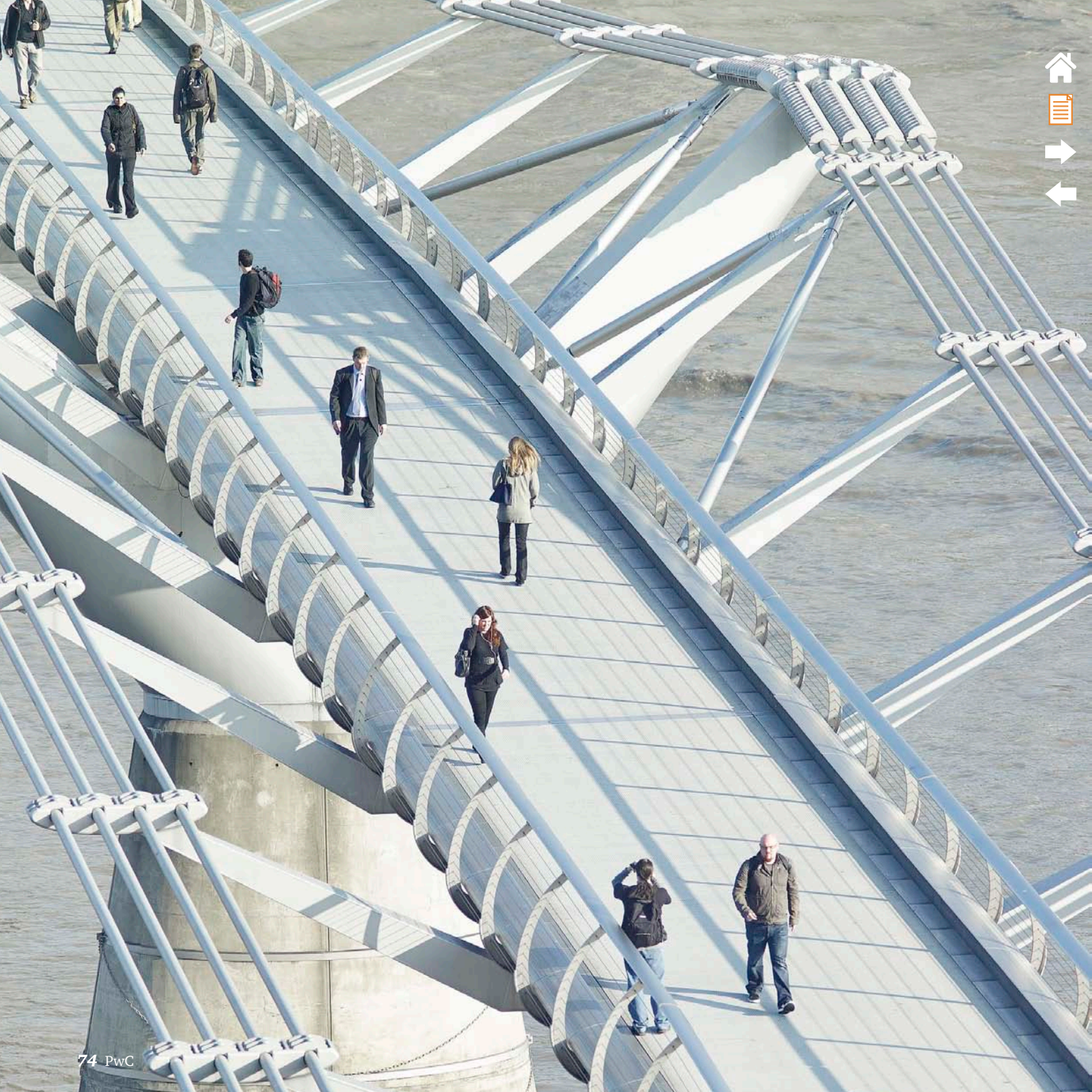
	2011	2012	2013
Lower quartile	35	61	60
Median	92	114	119
Upper quartile	180	220	239

Source: PwC analysis

State-owned companies

With the introduction of the new Companies Act, state-owned enterprises were required to be incorporated as state-owned companies (SOCs) and have to comply with regulations promulgated for all other companies, as well as the provisions of the Public Finance Management Act (PFMA). Prior to this, a state-owned company was either a company defined as a 'state-owned enterprise' in the PFMA or a company owned by a municipality.

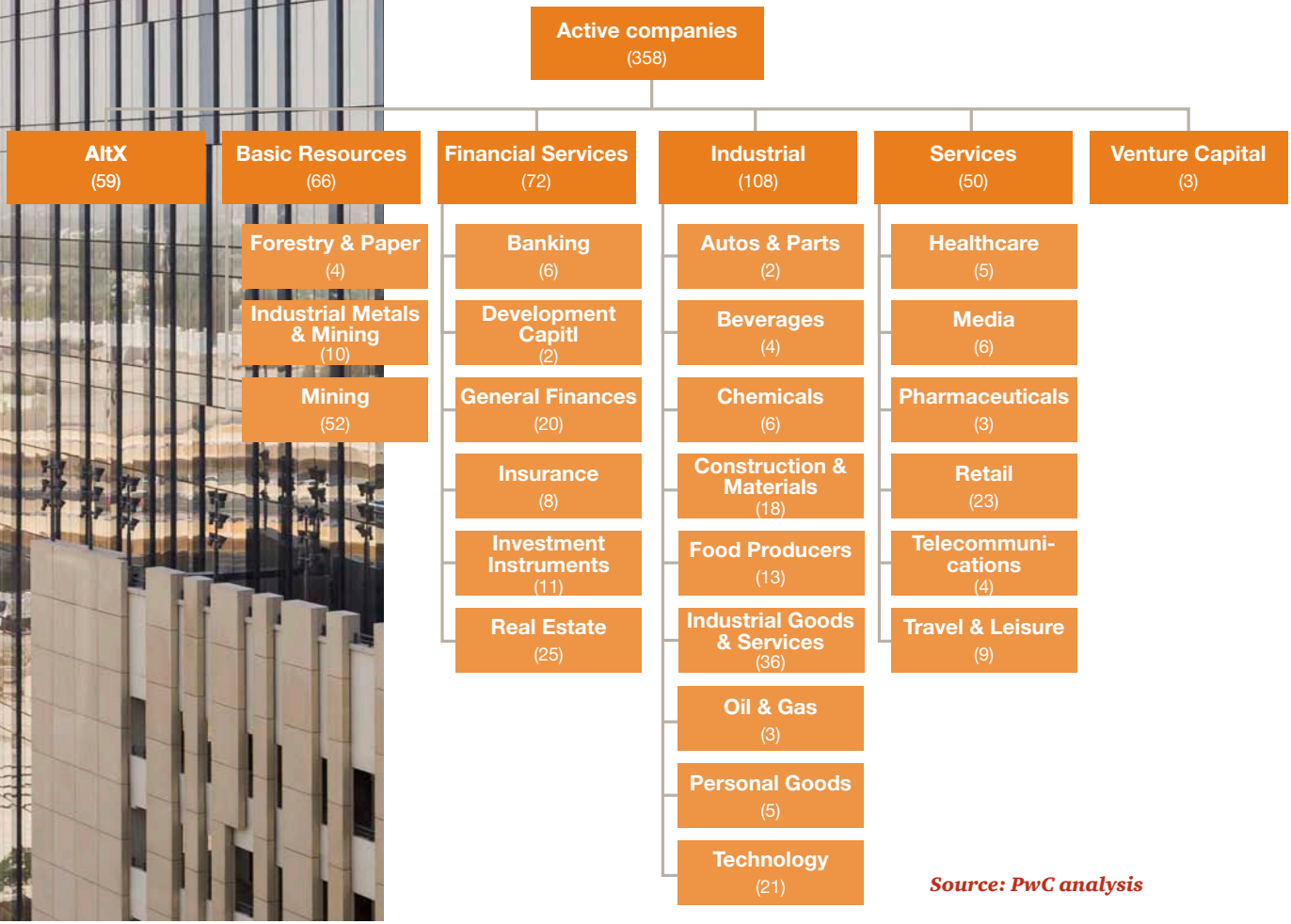
The Government is currently reviewing a set of rules and regulations regarding the level of remuneration for directors and fees for non-executive directors of SOCs. We understand promulgation of the regulations is imminent and look forward to providing analysis of remuneration practices in SOCs in future reports.



15

Appendices

The South African market place



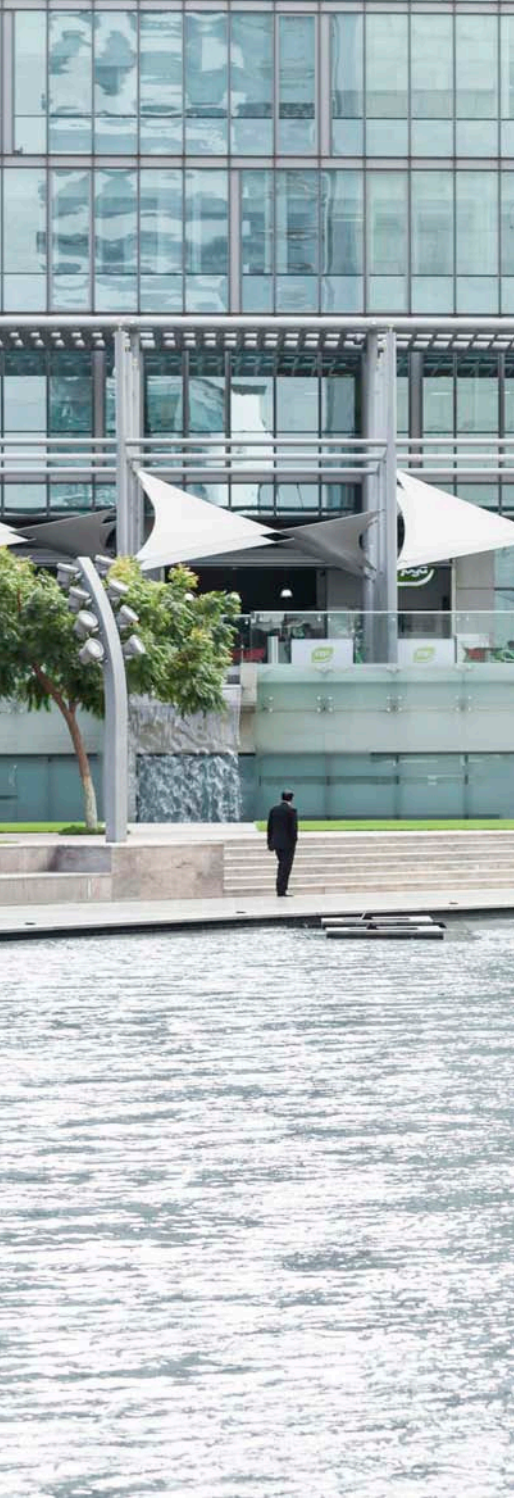
Source: PwC analysis

About PwC

At PwC we apply our industry knowledge and professional expertise to identify, report, protect, realise and create value for our clients and their stakeholders.

The strength of this value proposition is based on the breadth and depth of the firm's client relationships. Networks are built around clients to provide them with our collective knowledge and resources. Our international network, experience, industry knowledge and business understanding are used to build trust and create value for clients.

We are committed to making PwC distinctive through consistent behaviours that enable the success of our clients and people. We call this the PwC Experience and it shapes the way in which we interact with clients, with one another and with the communities in which we operate. This, along with our core values of Teamwork, Leadership and Excellence – and our strong Code of Conduct – guides us in all that we do.



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- David Yzelle, independent project researcher

For more information about the issues raised in this report, please contact:

- Gerald Seegers
  +27 11 797 4560
  gerald.seegers@za.pwc.com
- Martin Hopkins
  +27 11 797 5535
  martin.e.hopkins@za.pwc.com
- Karen Crous
  +27 11 797 4616
  karen.crous@za.pwc.com
- Julia Fourie
  +27 21 529 2170
  julia.fourie@za.pwc.com

For press enquiries, please contact:

- Sonja Nel
  +27 11 797 4207
  sonja.nel@za.pwc.com

Notes