



On the nomination and remuneration agenda

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Business recovery and growth, the long-term effects of the pandemic and ESG commitments are likely to continue to test the skills and experience of board members. Has the board taken the opportunity to review and potentially reshape board composition in line with any new strategic imperatives, review succession planning, and shift the dial in relation to fairness, equality and executive pay?

Executive compensation has been under intense scrutiny over the past two years and the heightened scrutiny is unlikely to lessen in a post-pandemic world. 2021 has been a record year for the number

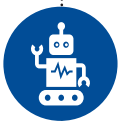
of shareholder and investor dissent, therefore, as businesses and economies start to recover, nomination and remuneration committees will have to carefully look at their policies and decisions around remuneration, with the continuing focus on restraint but also the impact of pay on the wider workforce.

Drawing on insights and interactions with directors and business leaders, we highlight key issues for nomination and remuneration committees to keep in mind as they consider and formulate their agenda for 2022.

Board skills required to support growth

Whilst the pandemic may have highlighted those skill sets that come to the fore in times of crisis, the continuing priority is to ensure that talent in the boardroom and in the executive ranks, is aligned to strategy. Demand for experience in

business transformation, recovery, technology and restructuring is likely to continue. Leadership styles have pivoted towards empathetic leadership and wellbeing issues have risen up the agenda.



Digitalisation, robotics and AI have increasingly become important components of corporate strategies. Individuals with deep technological expertise can be hired at an executive level but board members still need to be able to 'ask the right questions' and just as important, 'understand the answers', to be capable of contributing across the range of issues the board faces – but have the risks around inexperience been historically overstated? And even if not, have they now been surpassed by the potentially higher risks associated with a board lacking in technology literacy?



What steps is the nomination and remuneration committee taking to ensure the board, leadership and senior management team are fit for purpose and well placed to support recovery and growth? What development plans are in place to support both senior managers and those in the pipeline?



Advisory boards might be considered as a mechanism to fill any skill gaps and support the board in the execution of its duties. However, clarity over their role, authority and place within the organisation's governance framework will be key to success.



The use of third-party advisors to support the board in areas where specific expertise is needed will likely continue, but regulators and investors are increasingly seeking greater transparency around who such advisors are and any affiliations, financial interests or ties that might bias their judgement and therefore impact their advice.



Consider looking beyond the 'usual suspects' to find people with different experiences and backgrounds -including those who have not served on a listed company board before. Different **leadership styles may unlock organisational success¹** and with appropriate induction, mentoring and coaching, new directors should be able to adapt reasonably quickly.



Courage and the emotional intelligence to provide a balance of perspectives should not be underestimated as key requirements to help the CEO and organisation recover and support growth once again.

1. Balanced, authentic and empathetic leadership, KPMG, February 2021



Succession planning

Diversity has been highlighted at the heart of good governance, requiring nomination and remuneration committees to link their policies on diversity and inclusion firmly to their business strategy and to promote diversity in terms of new appointments and in their succession planning. However, many companies provide very little information on how they have sought the right mix of skills and perspectives to drive their long-term success.

While many listed companies provide details on their appointment process (including the use of external recruitment agencies), very few articulate the deeper considerations around succession planning, or the progression plans for those looking to move to board level.

Many Annual General meeting (AGM) notices relating to the re-election of directors simply cross-refer to the biographies included within the annual report and said nothing about how they contribute to the long-term success of the business. The more informative notices had detailed biographies and briefly explained why each director should be re-elected. The best clearly outlined the reasons for an individual's re-election, specifically linking their contributions to company strategy and risks.

Successors may be identified from 'rising stars' who have dealt with the impacts of the crisis and those that sit on multiple boards who can share insights from other organisations. The trend for boards to identify talented individuals to become 'board apprentices' to observe the boardroom and provide independent feedback, as well as gain valuable training to reach board level is increasing.

The continued use of online recruitment tools and practices such as video interviewing could help to widen the talent pool as physical meetings become less of a logistical barrier.

The committee should as far as possible, manage the retirement of board members so as to avoid losing too much 'corporate memory' in one go.



Skillsets to expand and enhance ESG oversight

Environmental, Social and Governance (ESG) has become a critical consideration for businesses, investors and shareholders across all sectors. Climate change is front and centre and social factors

have gained greater attention over the past year as COVID-19 forced practices to change, highlighting the social issues that were already there.



Oversight of ESG related risks – and equally importantly, the opportunities – starts with an ESG competent board. Not every board member needs to have deep-dive ESG expertise, but the board needs to have ESG risk and its impact on long-term value creation, top of mind. They need to understand which issues are of greatest risk or strategic significance to the company, how they are embedded into the company's core business activities, and whether there is strong executive leadership behind the company's response to the climate crisis.

Oversight of these risks and opportunities is a significant challenge, involving the full board and potentially multiple board committees. For example, elements of climate, ESG, and diversity, equity and inclusion oversight likely resides with the audit and remuneration committees – and other committees, like an ESG or sustainability committee, may have responsibilities as well. Overlap is to be expected, but this puts a premium on information sharing and communication among committees. It also requires that committees have the expertise to oversee the issues delegated to them.

What role is the nomination and remuneration committee playing in ensuring the board has the right skills and that the governance structures are fit for purpose? Is this addressed head-on as part of the annual board evaluation exercise? Does the company's succession plan explicitly address ESG competency?

ESG is also a critical consideration for businesses and continues to be high on the agenda of remuneration committees. Investors, regulators, employees, customers and other stakeholders will therefore hold clear expectations of how management interests have been aligned to ESG strategies and how they will be incentivised to bring those to fruition.



Linking executive pay and ESG metrics is a continuing conversation with organisations looking to implement some form of ESG metric into their long-term incentive. With majority of proxy advisors and investors encouraging the inclusion of ESG related performance measures, the question now is, how do you set targets? Below are talking points for boards and remuneration committees:

- **Prioritise** Whilst undoubtedly any board will be looking to achieve all elements of their ESG strategy, it is useful to prioritise which areas will be in focus in the next 3-5 years. This helps to provide milestones for achievement particularly where the objectives are very long term, such as climate related strategies.
- **Materiality** Many of the measures we are seeing introduced into long or short term incentives have a relatively low weightage. However, materiality reflects the importance of the chosen ESG metric and therefore a low percentage rating may not convey the importance.
- **Culture** How can the wider workforce also be incentivised? Bringing a collaborative approach and linking together the focus of the executives with that of the wider workforce, will not only reinforce a refreshed corporate culture, but also drive performance.

The voice of the workforce and wider stakeholder perspectives

Stakeholder perspectives are relevant for all board appointments and should be considered as part of succession planning. Given the significant influence that company's key stakeholders have on an organisation's prospects and licence to operate, the board's knowledge and understanding of the interests of those stakeholders is vital.

What is the nomination and remuneration committee's role in appointing a non-executive with designated responsibility for getting the voice of the workforce into the boardroom? Is there a formal process? Are specific characteristics and skill sets sought? Has consideration been given to tenure and rotation issues? Is more than one designated non-executive director necessary if the company has a large geographical footprint.

For many, workforce directors still sit uncomfortably with the traditional governance frameworks and are rare within the listed

companies. Nevertheless, they can provide tangible benefits to companies— particularly in an environment impacted by the ongoing effects of the pandemic, an imminent global recession and an undercurrent of social unrest. Does the decision to not have a workforce director need revisiting? What can be learned from those who have appointed workforce directors?

Again, this can be linked to the rise of ESG strategies and the need to have effective change management in terms of corporate culture becoming more focused on a fully inclusive environment and employee engagement and wellbeing.

It is also important in terms of ensuring a strong succession strategy and ensuring that pay policies are encouraging strong career development for a diverse workforce.



Enriching board decision making through visible and invisible diversity

Core to the nomination and remuneration committee role is ensuring that the board has the right combination of skills, backgrounds, experiences, and perspectives to probe and challenge management's strategic assumptions and to support management in navigating the company through an increasingly volatile and fast-paced global environment.

- Does the nomination and remuneration committee use personality testing or cognitive profiling to assess whether the board has a mix of personalities and decision making styles that best contribute to effective oversight and decision making?
- Expect continued legislative and regulatory action on board composition and diversity along with efforts to boost disclosures on diversity.²
- Also, be cognisant of the increased level of investor engagement on this issue – perhaps highlighting investor frustration over the relatively

slow pace of change in boardrooms and pointing to the central challenge with board composition: a changing business and risk landscape.

Addressing competitive threats and business model disruption, technological innovation and digital changes, climate and ESG risks, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, thinking, gender, and race/ethnicity, etc. – is central to that.

- Lastly, think about the breadth of the talent pool from which new board members are sought. Has sufficient attention been given to recruiting directors with backgrounds in the third sector, and academia, and in some instances, senior professionals who are still working full-time, and are available to allocate time for a role on the board? Challenge recruitment firms to provide a more diverse list of candidates and be specific about the skills and attributes required.

Innovative incentive arrangements

The debate around more innovative incentive ideas continues to develop and has only been enhanced by the need for fresh thinking on delivering executive compensation and long-term incentives.

However, with more companies having a renewed purpose and focusing on creating long-term sustainable business models, this will see an increased focus on the need for a more balanced view in terms of performance conditions (i.e., financial vs non-financial) and a more behavioural focused reward philosophy.



2. FCA consultation: Boosting diversity disclosures, KPMG, September 2021



Reputational dangers and the fairness agenda

Many listed companies have faced shareholder rebellions over executive pay this year compared to last year, due to many investors taking a harder line on the fairness of pay.

- As we have previously discussed, being in the news for excessive executive pay does not send the right message to potential investors and the public. Whilst the reputational impact of executive pay issues may not be immediately quantified, the nomination and remuneration committee and other key officers will spend a significant amount of time on issues which are not core to the business itself
- The fairness agenda is not a new topic, but its importance continues to increase and shows the need for continued restraint to be shown in respect of executive pay, but also the

remuneration committee must ensure that its pay decisions are reflective of the pay philosophy applied to all employees

- Whilst many companies have frozen executive pay, cancelled or revised bonus pay outs and been more conservative in terms of long-term incentive plan grants, investors have continued to vote against remuneration reports where they consider executives to have been shielded from the real impact of the pandemic. In many cases, even with the lower pay levels we have seen over the past year, some stakeholders would still consider the level of reward received by executives to be generous given the economic hardships experienced by the population, but particularly in cases where there has been a level of government support to protect businesses.

Planning for increasingly active engagement of the investors

Institutional investors are increasingly voicing their displeasure at the board against directors from the remuneration committee chair who display an unwillingness to change executive pay arrangements to the audit committee chair who presides over a period of accounting irregularities.

- ESG has now become a factor too with major investment houses going on record to say they would take voting action against directors at companies that were laggards based on their ESG scores and that could not articulate how they planned to improve their ESG metrics
- Furthermore, large institutional investors are looking to reduce the number of over-boarded directors on boards, through reinforcement of the general principle that executives should not have multiple external roles
- The nomination and remuneration committee chair in particular should be wary of non-adherence to leading practices both locally as well as globally, such as the board having not conducted an externally facilitated evaluation of its effectiveness or having an individual who has

a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests is nominated (or re-nominated) to the board

- Engaging with institutional investors on matters around executive pay has always been an important aspect of the ongoing dialogue between the company and its shareholders.

As investors increase the range of performance indicators which they assess businesses against nomination and remuneration committees need to be comfortable in their decisions with reference to the stated policies of their key investors.



Chairing the nomination and remuneration committee

Whilst having the **board chair as nomination and remuneration committee chair**³ has many benefits, for example visibility of the talent pipeline in the tiers below the board that are ready for development and succession planning, efficiency in communication between the nomination and remuneration committee and the board, and only one leadership style to work with, there may also be a propensity to unduly influence or force their own agenda and choices which could compromise the independence of the nomination and remuneration committee for example, in shaping and hiring key directors. Carefully consider what is right for your organisation and whether the existing model needs revisiting.

All boards have several diverse personalities and getting the most out of them is what defines a great chair. A chair who understands the differences between board members and how they approach any given situation will be better placed to harness their skills and attributes and ensure that the board is greater than the sum of its parts.



3. The Board Chair as Nomination Committee Chair, KPMG, September 2021

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