



# Directors' remuneration in FTSE Small Cap companies

August 2020

A wide-ranging overview of Executive and Non-Executive Directors' remuneration trends in Small Cap companies

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# Introduction

This report provides an analysis of trends in Directors' remuneration within the FTSE Small Cap market.

Our analysis includes an overview of the total executive pay package including basic salary and incentives as well as a review of additional reporting criteria such as gender pay gap.

Executive pay continues to remain a key area of attention for shareholders and the media in general, especially in the light of the COVID-19 pandemic. There is (and will continue to be) close scrutiny of how companies have reacted to this challenging environment. Our analysis in this report uses pre-COVID data published by companies for the 2019 year. We could, however, see a very different executive pay landscape in the coming year, as companies navigate pandemic-related cost control and accept curbs on senior management pay as a condition of receiving Government subsidised COVID-19 financial support.

The business impact response to COVID-19 has been varied. We have seen many companies adjusting their executive pay downwards, cancelling bonuses/dividends and amending LTIP grants in order to appropriately manage costs in the immediate to short-term. However, with the lifting of lockdown and ever present threat of infection resurgence, many companies must now start to plan for the future and consider what this means for their remuneration strategy longer term, as a new reality begins to emerge.

The global crisis has produced an increased public scrutiny on executive pay and concern that reductions in executive pay are temporary or superficial gestures only, at a time when executives have had to (and continue to) make tough decisions around salaries, jobs, furlough and the future of their staff. This, in turn, has led to more questions around the 'fairness' of pay. We therefore expect increasing momentum on this issue and calls for companies to look more broadly at how all their people are valued and rewarded. Whilst much of this scrutiny is aimed at the FTSE 350, we anticipate the impact of actions taken to filter down to the FTSE Small Cap and AIM listed communities.

From an investor perspective, there will be sharp focus on how executives are going to rebuild and then further increase shareholder value. Guidance from institutional investors has been clear that reward must consistently align to performance. The role of the Remuneration Committee Chair, in terms of applying discretionary judgement to outcomes, will become ever more important.

Undoubtedly the impact of COVID-19 will be far reaching and will have a lasting effect on areas of far greater consequence than executive pay. However the impact of the pandemic has varied across industries. With this polarity of impact and 2020 being the year that many companies will be required to renew their remuneration policies, we believe that there is a unique opportunity to look more inwardly at how executive pay has been set and critically analyse if this remains appropriate for the recovery period ahead, in particular as businesses prepare for the next challenge on the horizon in the shape of Brexit.

# Summary of key data findings

Remuneration changes within Small Cap companies continue to mirror that of larger companies within the FTSE 350, however there are some differences to note:

- Median basic salary increases continue to be moderate for the majority of Small Cap companies, at around 3%;
- There is a heavier weighting on fixed pay vs variable pay, with Small Cap companies showing a preference towards short term incentives in policy, such as annual bonuses for rewarding executives;
- Over 35% of directors did not receive an annual bonus, with a higher proportion than we have seen in previous years receiving less than 50% of the maximum bonus entitlement. This is a trend we expect to increase in the coming year as the effects of COVID-19 are felt in full;
- Performance conditions for annual bonuses continue to focus on the financial, with the EPS and TSR continuing to dominate both annual bonuses and long-term incentives;
- The prevalence of Performance Share Plans continues to rise, as Stock Option Plans fall further out of favour.

The analysis in this guide is based on Small Cap listed companies who published their annual report and accounts up to 31 December 2019 as analysed by E-Reward, an independent research organisation.





# Remuneration mix

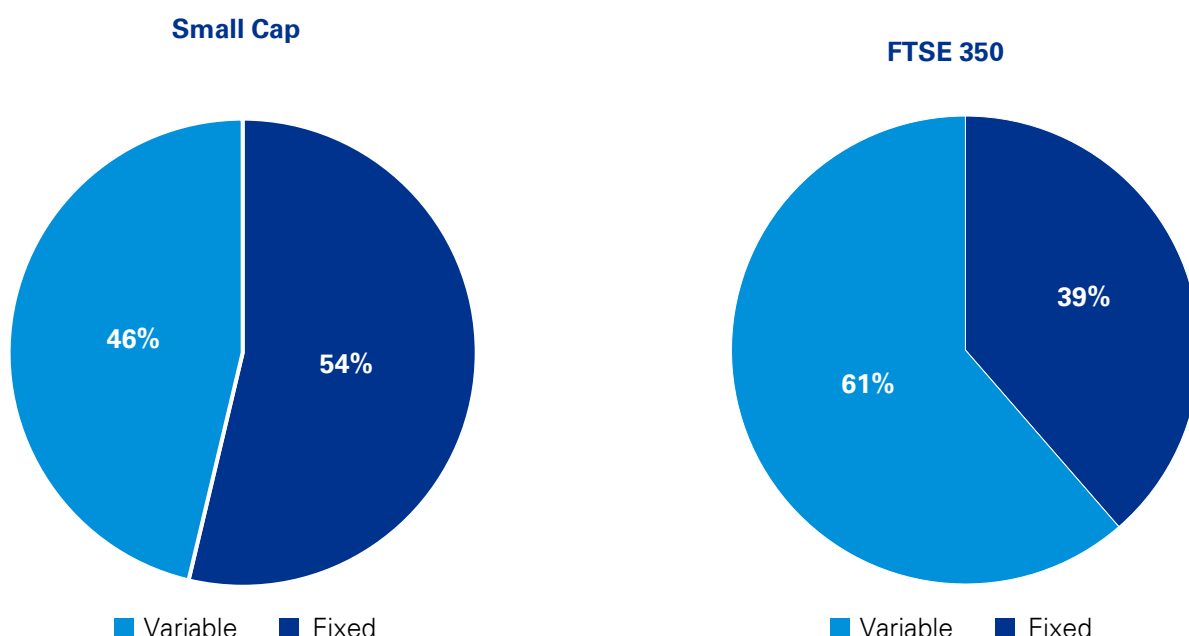
The chart below shows the mix between fixed and variable remuneration for a Chief Executive of a FTSE Small Cap listed company. The remuneration mix is shown in respect of the actual remuneration received in the year.

Most companies have an annual bonus plan and some form of long-term incentive in place. Based on the charts below we can see that the balance in favour of variable pay, being made up of annual bonus and long-term incentive payouts, is considerably higher for those companies listed on the FTSE main market, with just 39% of the actual pay received by Chief Executives of FTSE companies being in the form of fixed pay.

Chief Executives of those companies listed on the Small Cap Index also have a large proportion of their total remuneration package made up of variable pay, however we can see from the chart below that the proportion of total comp in the form of fixed pay is significantly higher when comparing these figures to that of FTSE main market companies. This larger weighting towards fixed pay reflects what we would typically see in AIM listed companies. As later analysis supports, we expect that this is due to the significantly lower potential and actual LTIP payouts that are typically seen within the FTSE 350.

It should be noted that the charts below show the actual pay data from the single figure pay table, received by the Chief Executive of the relevant company.

## Mix of pay – Fixed: Variable



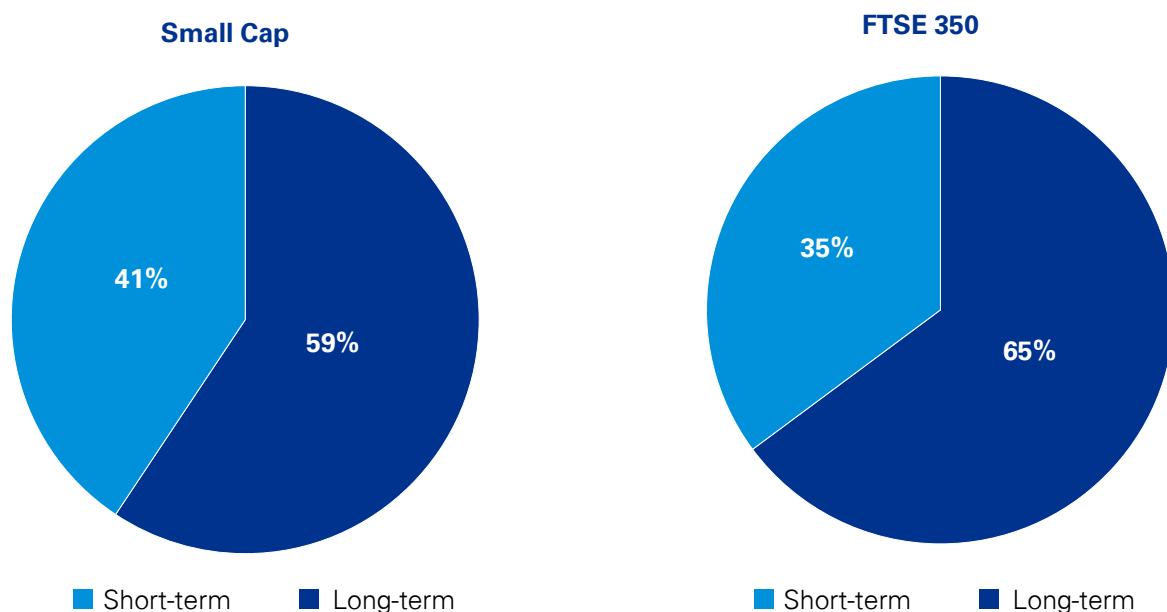
# Remuneration mix continued

Further analysis of the remuneration mix between short-term and long-term pay shows that the majority of remuneration received by the Chief Executive of a typical company listed on either Small Cap or FTSE Main Market, comes in the form of short-term pay.

From a comparison of the remuneration mix shown in the charts below (based on actual pay), we can see that the remuneration package of a typical company listed on the Small Cap index places a higher reliance on long-term pay as a percentage of total compensation when comparing this data to that of a typical FTSE main market company. This is likely to be due to depressed actual bonus figures in the data, as we would normally expect the reverse.

Short-term remuneration includes basic salary, benefits and annual bonus. Long-term includes LTIP gains. The data is based on actual remuneration received in the year using the median for the fixed and variable elements.

## Mix of remuneration – Short-term: Long-term



Further detail on incentive plans is included later in this report.

## Key factors

The following factors will all have had an impact on both the mix of fixed to variable and short to long-term remuneration:

- A number of companies may be new to the index and therefore incentives in place have not yet had a chance to vest;
- Many directors will have an existing shareholding in the company and, as such, will already be aligned to the success of the company without additional reward via a traditional LTIP;
- Company performance which impacts the extent to which annual bonuses and LTIPs vest; and
- The underlying value of a company's share price where variable pay is delivered in the form of shares.

# Basic salary, total cash and total earnings

The table below shows the lower quartile, median and upper quartile basic salary, total cash and total earnings for the directors of a company listed on the Small Cap Index.

From a review of the figures noted in the table below, we can see a marked difference in the take home pay of a Chief Executive versus that of either a Finance Director or Other Director of a Small Cap company. The take home pay of a Finance Director and Other Executive is broadly similar, however we see a premium of around 50% for the amount of remuneration received by the Chief Executive.

It is also interesting to note that, at the upper quartile of total earnings, the ratio of pay received by the CEO to that of the Finance Director and Other Executive Director increases. This demonstrates the impact that the additional leverage of large long-term incentive arrangement can have on remuneration package.

## Executive pay breakdown

£'000	Basic Salary			Total Cash			Total Earnings		
	Lower Quartile	Median	Upper Quartile	Lower Quartile	Median	Upper Quartile	Lower Quartile	Median	Upper Quartile
Chief Executive	£336	£411	£471	£434	£606	£809	£498	£728	£1,278
Finance Director	£216	£257	£323	£288	£379	£495	£301	£477	£757
Other Executive Directors	£185	£252	£296	£240	£328	£438	£317	£466	£776

The table below shows the median pay increases awarded to directors across the Small cap, FTSE Mid-250 and FTSE 100 indexes.

Across each Index we can see modest pay rises for each director role, with a 3% increase being the most common salary increase awarded. As the base salary paid to an executive forms part of the total cash portion of the remuneration package, we expect further scrutiny to be applied in this area, especially with the impact of COVID-19 and the reductions in pension contributions awarded to executives.

## Median Salary increases

Median Salary increases			
	Small Cap	Mid-250	FTSE100
Chief Executive	3%	3%	3%
Finance Director	4%	3%	3%
Other Executive Directors	3%	3%	7%

# Basic salary

There is an assumption across all markets that the size of a company is highly correlated with basic salary levels of Executive Directors. This assumption is particularly well supported by the base salaries in place for Chief Executives in Small Cap companies.

The tables below shows basic salary levels by market capitalisation.

Chief Executive (Small Cap) – Basic salary by Market Capitalisation			
£'000 Market Capitalisation	Lower Quartile	Median	Upper Quartile
>£250 million	£387,200	£446,381	£506,500
£150 million - £250 million	£333,500	£366,170	£415,550
<£150 million	£310,500	£426,000	£457,500
All	£348,000	£431,100	£471,000

Finance Director (Small Cap) – Basic salary by Market Capitalisation			
£'000 Market Capitalisation	Lower Quartile	Median	Upper Quartile
>£250 million	£255,750	£310,000	£333,250
£150 million - £250 million	£220,000	£237,968	£322,875
<£150 million	£248,000	£264,500	£287,000
All	£250,000	£300,391	£328,000

Other Executive Director (Small Cap) – Basic salary by Market Capitalisation			
£'000 Market Capitalisation	Lower Quartile	Median	Upper Quartile
>£250 million	£253,593	£283,000	£350,500
£150 million - £250 million	£171,000	£219,000	£278,300
<£150 million	£218,250	£242,500	£266,750
All	£210,000	£258,370	£305,800

The tables below shows basic salary levels by turnover.

Chief Executive (Small Cap) – Basic salary by Turnover			
£'000 Turnover	Lower Quartile	Median	Upper Quartile
>£400 million	£439,750	£455,500	£532,747
£400 million - £200 million	£376,543	£405,500	£479,750
<£200 million	£333,500	£375,000	£430,550
All	£348,000	£431,100	£471,000

Finance Director (Small Cap) – Basic salary by Turnover			
£'000 Turnover	Lower Quartile	Median	Upper Quartile
>£400 million	£264,250	£326,838	£354,250
£400 million - £200 million	£248,984	£266,500	£308,837
<£200 million	£243,025	£281,000	£318,625
All	£250,000	£300,391	£328,000

Other Executive Director (Small Cap) – Basic salary by Turnover			
£'000 Turnover	Lower Quartile	Median	Upper Quartile
>£400 million	£286,500	£291,000	£345,000
£400 million - £200 million	£262,250	£297,000	£346,750
<£200 million	£195,500	£240,000	£289,750
All	£210,000	£258,370	£305,800







# Annual incentives

The vast majority of Small Cap companies included in the survey disclosed that they operate an annual bonus plan.

The table below shows the maximum typical bonus opportunity for Chief Executive, Finance Director and Other Executive Director roles. From this analysis we can see that the median maximum bonus opportunity awarded to each Executive Director is in the region of 120% of annual salary. This is a slight increase from the results seen in our Small Cap Survey published in 2016, which instead showed a median figure of 100% of annual salary.

## Maximum Annual Bonus opportunity per Director

Maximum bonus opportunity (percentage of salary)			
	Lower Quartile	Median	Upper Quartile
Chief Executive	100%	125%	150%
Finance Director	100%	120%	150%
Other Executive Director	100%	120%	150%

The table below analyses the maximum bonus opportunity awarded to a Chief Executive, split by company market capitalisation. From this we can see that the relative size of the company has an effect on the relative size of the bonus opportunity awarded to a Chief Executive, with the bonus opportunity typically increasing for those larger companies in the Small Cap index.

## Maximum Annual Bonus opportunity split by company size

Maximum bonus opportunity of a Chief Executive (percentage of salary)			
Market cap	Lower Quartile	Median	Upper Quartile
>£250 million	120%	150%	150%
£150 million - £250 million	100%	100%	125%
<£150 million	80%	100%	100%
All	100%	125%	150%

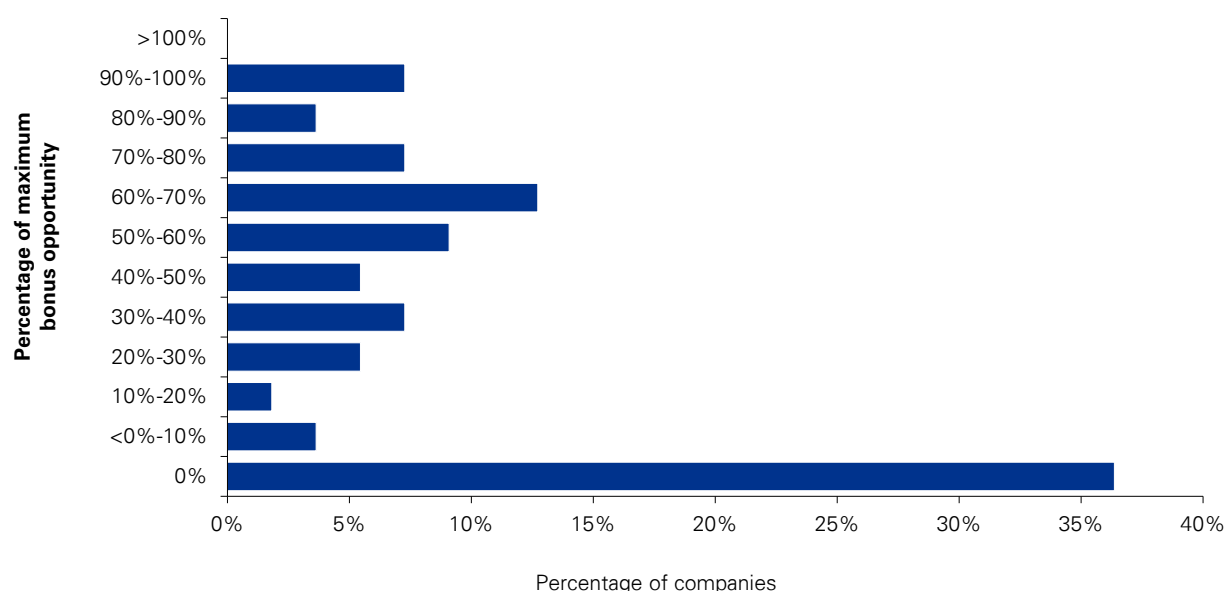
# Annual incentives continued

The chart below shows the value received by an Executive Director relative to the maximum bonus opportunity which was awarded to the director.

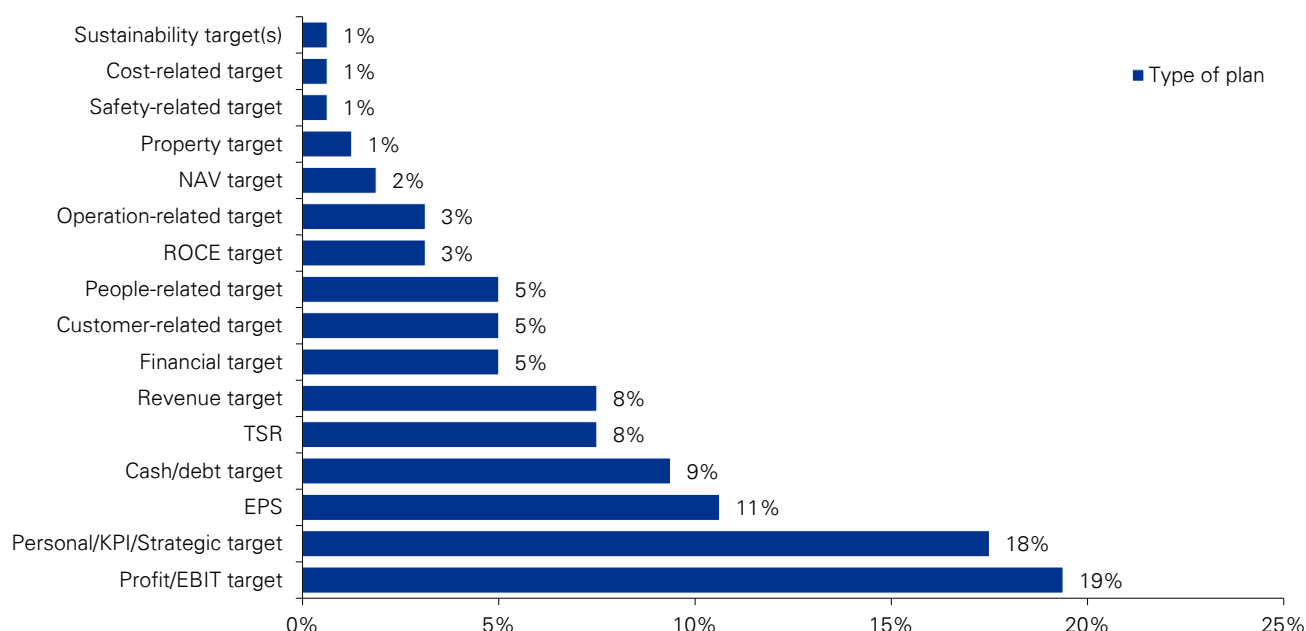
From this, it is evident that a significant number, over 35%, of directors received no payment in respect of an annual bonus. (This is a significant difference to our survey results of the constituent companies of the Main Market, published last year, which instead showed that the majority of companies made a bonus payment in the region of 65%- 70%). The reasons for such lower bonus payouts could be in relation to lower company performance or an indicator of more challenging bonus targets set by Remuneration Committees. However, with the impact of the COVID-19 pandemic in 2020, we expect it likely that we will see even fewer directors receive any bonus payments in 2020/21.

In terms of the nature of performance conditions applied, we have seen little change on prior years, even with the increasing pressure to apply Environmental, Social and Governance (ESG) targets. However, with a number of listed companies already leading the way on the introduction of these targets to their short and long term incentives, we anticipate this to also filter down to the Small Cap population, in the near future.

**Chart showing the percentage of maximum bonus opportunity paid to an Executive Director**



**Performance conditions applied to Annual Bonus awards**

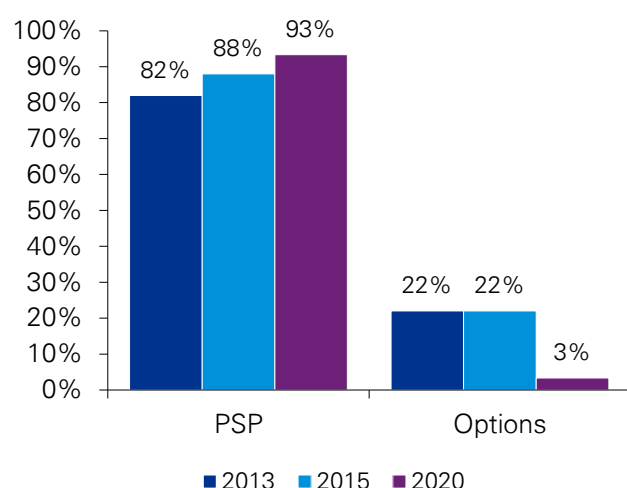


# Long-term incentive plans (LTIP)

The term LTIP is a generic term which can cover a wide range of different structures. LTIPs deliver cash and/or share awards to employees and are typically subject to the satisfaction of performance and/or service conditions. They operate over more than one financial year (awards subject to performance and service conditions of one year or less are known as short term incentives).

From the graph below we can see that there has been a noticeable reduction in the use of option plans operated by companies in the Small Cap Index. Whereas, the trend towards the adoption and operation of a Performance Share Award has continued with nearly all surveyed Small Cap companies operating a PSP, suggesting that most companies are using these as a replacement for their historical option plans.

## Plans operated



## Performance Share Plans ("PSPs")

A PSP is typically made in the form of an award of free shares (or shares at nominal cost) which vest upon the achievement of performance targets and continued service, normally over a period of up to three years.

## Options

An option plan typically provides an individual with the right to purchase shares at a specific set price in the future (varying between nil and market value).

Subject to eligibility, an option arrangement can take the form of a statutory tax-advantaged option plan, such as an Enterprise Management Incentive ("EMI") or Company Share Option Plan ("CSOP"), which can provide tax efficiency for the company and participants.

The table below shows the typical size of an award made to a Chief Executive, Finance Director and Other Executive Director of a Small Cap company under a long-term incentive plan.

From this analysis we can see the typical size of an award made to an executive director is equal to 100% of their base salary. The relative size of an award made to each executive is broadly similar, however in most cases the quantum of an award made to a Chief Executive will be larger due to their higher base salary.

## LTIP grant data

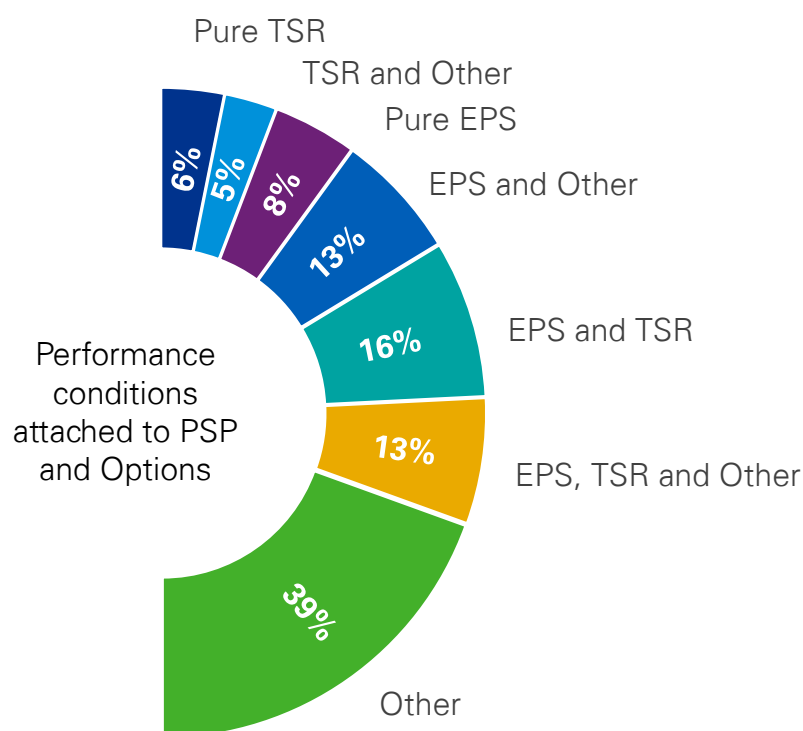
LTIP Grant (percentage of salary) – SmallCap			
	Lower Quartile	Median	Upper Quartile
Chief Executive	98%	100%	160%
Finance Director	74%	100%	151%
Other Executive Director	82%	100%	153%

# Long-term incentive plans continued

Disclosure of performance conditions for PSPs is limited. The chart below shows the prevalence of these conditions for those companies who disclosed this information.

From this data we can see a continued reliance on Total Shareholder Return ("TSR") and Earnings Per Share ("EPS"), with 61% of companies choosing to apply these performance metrics. The 'Other' category encompasses a wide range of measures including conditions based on share price growth, EBITDA and ROCE, as well as non-financial measures such as employee engagement and sustainability targets.

As with the annual bonus, ESG targets are gaining significant traction and most Main Market listed companies will focus on their own long-term sustainability. However, the movement towards applying the achievement of these ESG objectives to executive pay is still slow. A number of the FTSE 350 are now including some small weighting to their long-term incentive plans, or indicating that there is a plan in the near future to do so.





# Non-Executive Directors

The table below shows the basic fees for the roles of Chair and Non-Executive Directors, as well as the additional fees provided for membership of a particular committee and acting as chair thereof. Basic fees are exclusive of any additional fee which may be paid.

Fewer companies pay an additional fee for membership of a committee compared to that of chairing the committee.

There are a number of committees which may be operated, we have analysed the most common. Other committees may include, but are not limited to; Nomination Committee, Risk Committee, Corporate Social Responsibility Committee and Investment Committee.

## Fees paid to Non-Executive Directors

Non-Executive director fees	Lower Quartile (£)	Median (£)	Upper Quartile (£)
<b>Basic fees</b>			
Chair	126,912	151,500	196,291
Non-Executive directors	44,000	48,000	53,000
<b>Additional Fees</b>			
Senior independent director	5,000	7,750	10,000
Chair of the Remuneration Committee	7,425	8,954	10,000
Member of the Remuneration Committee	7,625	9,000	13,750
Chair of the Audit Committee	7,000	8,585	10,000
Member of the Audit Committee	5,000	5,000	5,000

## Time commitment

There is insufficient disclosure in companies' annual reports with respect to the time commitment required of a Non-Executive Chair or Non-Executive Director role to perform any robust analysis. However, prior experience tells us that a Non-Executive Chair role typically demands around one full day a week. This will vary depending on the size of the company.

Other Non-Executive Directors roles will require less time commitment and this is reflected in the reduced fees. However, due to increased scrutiny of boards and directors, the time commitment required by a Non-Executive Director has increased in recent years. The number of board meetings will vary depending on company size and complexity.



# Diversity

## Diversity

This section looks at the proportion of men and women in Executive Director roles

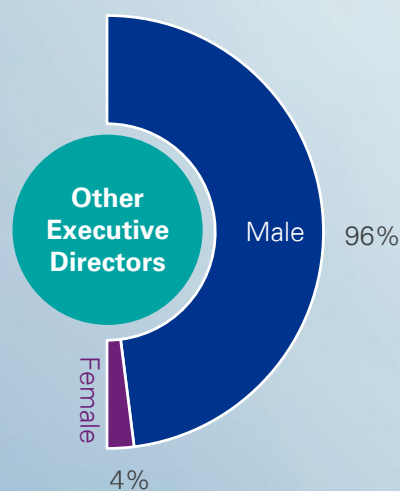
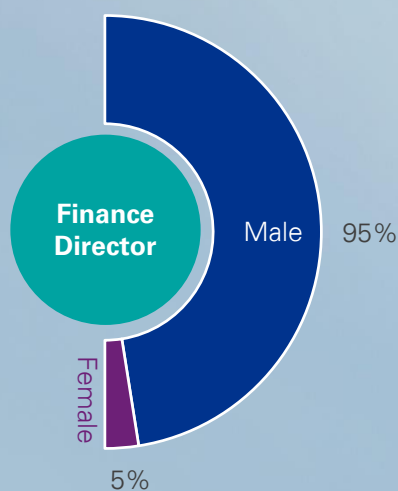
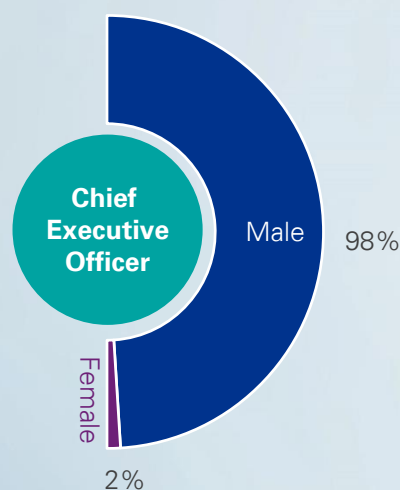
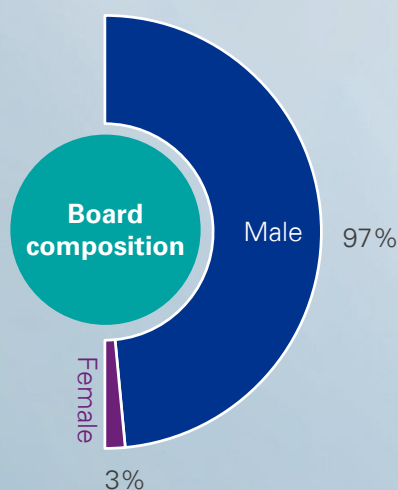
The introduction of Gender Pay Gap reporting for any organisation with 250 UK employees or more in the private, public and voluntary sectors has served to intensify the gender and pay debate generally, and the board room is not immune from this.

In addition to gender pay gap, other reporting requirements are adding to this debate in terms of the lack of ethnic and racial diversity at the top executive level.

## Board Composition

The concentration on boardroom diversity has principally fallen on the constituent companies of the FTSE 350.

However, as you can see from the data below, there is still significant work to be done in this area, for Small Cap companies, in order to create a greater parity at Board and executive level.







# Methodology

The analysis in this guide is based on Small Cap listed companies who published their annual report and accounts up to 31 December 2019 as analysed by E-Reward, an independent research organisation.

## Data sources

Unless otherwise stated, all graphs and tables in this guide have been created by KPMG, from data provided by E-Reward. The data provided has been further analysed using the methodology outlined below.

## Data sample

Market constituents and market capitalisation figures are as at 31 December 2019 and turnover figures used for the analysis are as at the relevant reporting date for each company.

The positions included in the data sample are: Chief Executives, Finance Director and Other Executive Directors. Other Executive Directors includes any main board position other than the Chief Executive, Finance Directors, Executive Chair and the Non-Executive Directors. This typically includes operational directors, functional directors, and chief operating officers.

To enable the remuneration components of each position to be analysed they have been split into the following categories:

## Base salary

Annual salary received over a 12-month period as shown in the accounts (not necessarily set at annual review).

## Total cash

The sum of basic salary, benefits and total bonus.

## Total earnings

The sum of total cash, the cash value of any PSP awards vested during the year and the cash value of any share options exercised during the year. The final figure may also include some miscellaneous payments not shown in the published tables.

## LTIP awards

LTIP awards are considered for the purpose of the guide to be awards where the vesting/performance period is longer than one year and have been categorised in the guide as:

- PSP or Performance Share Plan – a type of long-term incentive in which participants are allocated shares or, more commonly, rights to shares, the vesting of which is subject to the satisfaction of performance targets over a period of more than one year.
- Share Option – a type of long-term incentive structured as a call option that gives a right to buy a share some time in the future at the price specified at the outset.

For the actual analysis, the face value of performance shares and options has been estimated for the individual grants using the share price on award or the exercise price of the option.



# How KPMG can help

KPMG is one of the UK's leading advisors on employee incentives and executive compensation. Our team has a wealth of experience within the Small Cap sector and are able to advise on market practice, incentive plan design, tax, regulatory and accounting aspects of cash and share-based incentive plans.

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