

BC Directors Club

Director Compensation

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SFU Harbour Centre
Presented by Roger Gurr

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Corporate Governance Environment

Financial

- Manage earnings expense
- Manage dilution
- Cost vs. perceived value
- Economic conditions

Regulators

- CICA (CDN)
- FASB (US)
- IASB
- SEC (US)

Lawmakers

- Sarbanes-Oxley Act
- OSC (CDN)
- Deferred compensation reform (US)

Responsible Executive/Director Pay

Stakeholders

- Shareholders
- Proxy advisory firms
- Employees/retirees
- Labour unions
- Institutional investors
- Corporate governance reformers

Media

- Heightened vigilance and scepticisms

Stock Exchanges

- New proposed governance rules
- Listing requirements

Corporate Governance

● Evolution

- Rapid change in corporate governance practices & regulations
- High profile example of corporate malfeasance
- Pressure of institutional investors
- Greater exposure of director liability
- Regulatory environment – Sarbanes-Oxley had an immediate impact upon Canadian companies (listed or not on US exchanges)
- Increased emphasis upon director independence

Corporate Governance

- **Implications for Directors**

- Greater risk & exposure
- Increased accountability & time commitment
- Pressure to serve on fewer Boards
- Supply shortage of qualified directors

Corporate Governance

- ***Management of Governance***

- Independent Chair of Board; emergence of Lead Director
- Clarification of role of director
 - Board Charter
 - Committee Charters
- Increasing importance of Committees, especially Audit
- More *in camera* meetings
- Need to understand the business
 - Joint Director/executive meetings
 - Review of plans, objectives

Corporate Governance

- **Implications for Director Pay**

- Increasing more rapidly (about 10 –20% per year) than executive pay (3 –5%)
- Reviewed annually
- Method of pay (retainer and/or meeting fee)
- Role of director
 - Oversee management/direction of company
 - Attend meetings
- Early movement towards flat fee (assume directors attend meetings)

Corporate Governance

- **Implications for Director Pay**
 - Stock options out-of-favour – move towards DSUs (deferred share units) with payout upon retirement or leaving Board
 - Committee work & responsibility (Audit and Special Committee) receiving additional rewards

Pay – Large Companies

Very Large Companies (TSX 100) – Mercer Report

Median Total Compensation

	2002	2003	% Increase
Non Exec Chair	\$197,051	\$213,924	9%
Committee Chair	64,991	79,135	22%
Regular Director	59,991	73,000	22%

Committee Chairs sits on one Committee and chairs another

Regular Director sits on two Committees

Pay – Large Companies

Large/Medium Companies (Assets over \$500 million) – O'Callaghan Report

Assets	Average Total Cash Compensation (2002)		
	500 M – 1B	1B – 5B	> 5B
Non Exec Chair			
Retainer	\$76,580	\$132,585	\$225,771
Director			
Retainer	14,576	19,716	27,873
Meeting Fee	1,148	1,386	1,507

Report indicated that in 2002 vs. 2001 director retainer and meeting fees increased by 5 – 15%.

Pay – Large Companies

- **Recent Trends**

- **TSX 100**

- 40% differentiated fees for Audit Committee Chair
- 7% paid higher retainer to Compensation Committee Chair than other Committees (except Audit)

- Prevalence of DSUs (Phantom shares of equity with a value equal to one common share) increasing amongst larger companies
- 60 % of TSX 100 companies have (or are planning to introduce) share ownership guidelines for directors

Pay – Large Companies

- **Recent Trends**

- Theory is that guidelines & DSUs result in increased ownership and better alignment with shareholder interests
- In 2003, 14 companies of TSX 100 introduced flat-fee approach for directors e.g.
 - BCE \$150,000 per year
 - Brascan Group \$ 50,000 per year

Pay – Small Cap Technology Companies

- Companies with market cap 25 – 250 million
- Current proxy data analysis (year 2003) of retainer, meeting fees and equity
- 92 companies included in research:

By Location		By Industry	
BC	21%	Computer & Software	34%
Alberta	15%	Biotech & Pharma	41%
Ontario	31%	Telecommunications	11%
Quebec	33%	Electrical & Electronics	14%

- Comparisons made with last year (2002 data with 150 companies) to indicate trends

Small Cap Tech Companies – Board Size & Director Independence

	<i>Average Board Size</i>			<i>Independent Board Chair % Companies</i>	<i>Average Number of Committees</i>
	<i>Independent</i>	<i>Total Board</i>	<i>% Independent</i>		
All Companies	5.1	6.9	73%	42%	2.8
By Location					
BC	5.4	7.0	77%	47%	3.1
Alberta	4.6	6.2	74%	43%	2.4
Ontario	4.8	6.7	73%	41%	2.9
Quebec	5.3	7.4	72%	40%	2.7
By Industry					
Computer & Software	4.4	6.5	68%	35%	2.5
Biotechnology & Pharmaceutical	5.8	7.4	78%	47%	3.1
Telecommunications	4.8	6.4	75%	60%	2.7
Electrical & Electronics	4.8	6.9	69%	31%	2.6

Small Cap Tech Companies – Method of Compensation

	Cash & Equity	Cash Only	Equity Only	No Comp.
All Companies	64%	17%	11%	0%
By Location				
BC	63%	16%	21%	0%
By Industry				
Computer & Software	64%	26%	10%	0%
Biotech & Pharma	84%	3%	13%	0%
Telecommunications	50%	40%	10%	0%
Electrical & Electronics	54%	31%	15%	0%

Comparison to previous year – Increased prevalence of cash

Small Cap Tech Companies – Cash Compensation

- **81 out of 92 companies (88%) pay some form of cash**
- **Cash is paid in form of**
 - Retainer & meeting fees 59%
 - Retainer only 14%
 - Meeting fees only 27%
- **Some companies pay retainers (or higher levels) for unrelated Chairs & Committee Chairs**

Small Cap Tech Companies – Cash Compensation

Board Members:

All Companies

	Annual Retainer	Board Meeting Fee
P75	\$10,875	\$ 1,250
P50 (median)	6,750	1,000
P25	0	0
Range	\$ 0 – 30,000	\$0 – 2,000

- Companies paid Committee fees at (or slightly) less than full Board meeting fees
- Fees for telephone meetings tended to be at 50% full attendance rate
- Comparison to previous year – median retainer and meeting fees increased by 30 –35%

Small Cap Tech Companies – Cash Compensation

Specific Responsibilities

- **Unrelated Chair** tend to receive significantly higher compensation, usually in form of retainer as follows:

All Companies	<u>Annual Retainer</u>
P75	\$47,830
P50 (median)	15,000
P25	10,000

- Some Chairs receive no meeting fees, while others receive higher meeting fees than other directors (in addition to higher retainer)
- Comparison to previous year – some companies significantly increased annual retainer for unrelated Chair.

Small Cap Tech Companies – Estimated Annual Total Cash

- Based upon market practices for 92 companies, annual total cash compensation calculated for typical unrelated director
- Typical director :
 - Attends 7 Board meetings
 - Has membership in 2 Committees (one as Chair)
 - Attends 3 meetings per Committee
- Annual cash compensation is:

	Canada	BC
P75	\$25,300	\$25,750
P50 (median)	17,175	21,450
P25	10,000	10,000

Comparison to previous year – increases in the range of 25%, some significant (higher) increases in BC

Small Cap Tech Companies – Value of Stock Options

- 72% of companies provided some form of equity based compensation to directors
- Majority still provide options (KISS principle for small companies)
- Limited emergence of DSUs
- Issuances tend to be *ad hoc*
- Face value of equity (number of options X exercise price) is:

	Board Member	Board Chair
P75	\$71,660	\$91,500
P50 (median)	30,000	44,100
P25	11,550	20,350

Small Cap Tech Companies – Value of Stock Options

- One time issuances to Board members (upon appointment to Board) tend to be 2 –4 times the normal (sometimes annual) issuance
- Using a Black Scholes valuation of 0.4, the typical (median) option issuance to unrelated directors would be \$12,000 ($\$30,000 \times 0.4$)

Small Cap Tech Companies – Summary of Value for Service

- Assume best case for unrelated directors – both equity and cash
- Consider market median practices
- Annual value of compensation would be:

	Canada	BC
Number of companies	92	19
Cash	17,175	21,450
Equity	12,000	12,000
Total	\$ 29,175	\$ 33,450

- Note that options are *at risk* compensation
- Some increase (20 –30%) in cash compensation in 2003 (vs 2002)
– still not well paid!

Private Companies

- **Overall private companies (relative to publicly traded) pay more conservatively –10 to 20% below market**
- **More reluctant to remunerate directors and advisors with cash**
- **Trend towards providing equity (real stock or options) but some family-owned still reluctant**
- **Question is how much dilution do owners forego and how is the issuance of equity managed (vesting, held in trust, etc.)**

Private Companies – Intending to go Public

- **Studies have indicated that median ownership at various stages of development are as follows:**

	Early/ Seed	Mid/Late	Pre IPO
Investors	44%	60%	65%
Founders	44%	20%	13%
Employees/Unrelated directors	12%	20%	22%

- **Professional director (not investor) could reasonably expect eventually 1 - 2% ownership**
- **Limit total unrelated director ownership to 5 – 10%**

Conclusions

- Larger companies are rapidly increasing director pay - % increases have higher absolute \$ increase
- Small cap companies lag. Directors still underpaid relative to:
 - Equivalent to value of CFO rate of 1 day per week
 $\$180,00 \times 20\% = \$36,000$ cash + options
 - Consulting 3 days per month at \$200 per hour (7 hour day)
 $3 \times 12 \times \$1,400 = \$50,000$ cash with no options
- Current level of cash compensation (median of \$17,000 to 22,000) does not reflect value (?)

The Future

- Compensation for directors will continue to increase
- Pressure will continue to provide some cash compensation – directors relative to executives
- Director pay will be formalized– new regulations will legislate more transparency/information
- Small cap companies – directors expected to have (at least) 1% ownership
- Continued pressure to better represent the interests of shareholders – act independent of management
- Need to carefully manage the process of review and approval of director pay to avoid appearance of *self dealing*

Canadian Small Cap Companies with Market Capitalization between \$25 and \$250 million

	Biotech & Pharma	Computer & Software	Electrical & Electronic	Telecommunications
Alberta	Biomira Inc BioMS Medical Corp CV Technologies Inc. Isotechnika Inc Oncolytics Biotech Inc	Chartwell Technology Inc Computer Modelling Group Ltd Matrikon Inc. Zi Corporation	Qsound Labs Inc	CSI Wireless Inc Guest-Tek Interactive Entertainment Ltd Wi-LAN Inc Wireless Matrix
BC	AnorMED Inc Cardiome Pharma Corp Forbes Medi-Tech Inc Inex Pharmaceuticals Corporation Inflazyme Pharmaceuticals Ltd International Wex Technologies Inc Migenex Inc Response Biomedical Corp Stressgen Biotechnologies Corporation	ACD Systems International Inc. Datawest Solutions Inc Infowave Software inc MDSI Mobile Data Solutions Inc. Offshore Systems International Ltd	Extreme CCTV Inc. Gientel Inc Norsat International Inc Spectrum Signal Processing Inc.	Digital Dispatch Systems Inc
Ontario	Adherex Technologies Inc Bioniche Life Sciences Inc ChondroGene Limited Dimethaid Research Inc. Helix BioPharma Corp Lorus Therapeutics Spectral Diagnostics Inc Tm Bioscience Corporation Transition Therapeutics Inc Viventia Biotech Inc YM BioSciences Inc	724 Solutions Inc. AirIQ Inc Belzberg Technologies Inc Brainhunter Inc DataMirror Corporation Descartes Systems Group Enghouse Systems Limited Financial Models Company Inc MKS Inc Systems Xcellence Inc. Workbrain Corporation	Certicom Corp Coretec Inc Firan Technology Group Corporation MOSAID Technologies Inc NBS Technologies Inc SAMSys Technologies Inc	COM DEV International Inc.

Canadian Small Cap Companies with Market Capitalization between \$25 and \$250 million

Quebec

Biotech & Pharma

BioEnvelop Technologies Corp
 ConjuChem Inc
 DiagnoCure Inc
 Draxis Health Inc.
 Ecopia BioSciences Inc.
 LAB International Inc
 Labopharm Inc.
 MethyGene Inc
 Nexia Biotechnologies Inc
 Paladin Labs Inc
 Procyon BioPharma Inc
 Theratechnologies Inc
 Warnex Inc

Computer & Software

AD OPT Technologies Inc
 Boomerang Tracking Inc
 Evolved Digital Systems Inc
 Honeybee Technology
 Logibec Groupe Informatique Ltée
 Mediagrif Interactive Technologies Inc.
 MediSolution Ltd
 Nexxlink Technologies Inc.
 Nstein Technologies Inc
 Nurun Inc
 Speedware Corp

Electrical & Electronic

NHC Communications Inc.
 Optimal Group Inc

Telecommunications

Bell Canada International
 Mamma.com Inc
 Mitec Telecom Inc.
 SR Telecom

