Pearl Meyer

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Working Overtime: Board Compensation at Small- and Mid-Cap Growth Companies

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The last three years have been a rollercoaster ride for small- and mid-cap (SMID) growth companies. Easier access to capital in the wake of COVID-19 created a frenzied environment which saw many companies go public via SPAC or IPO much sooner than they normally would. Companies that were already public reached new all-time highs. However, as regulators caught up and the rising rate of inflation kicked the federal reserve into action, the frenzied activity came to a screeching halt in the first half of 2022. While some areas of the market have since recovered, SMID-cap valuations generally remain low.

While market sentiment peaked and (hopefully) troughed over this period, one thing didn’t change: director workload. In fact, some might argue it has increased. Boards, management teams, and shareholders share in the pain as companies try to stabilize. This often requires an extraordinary time commitment from directors, which has been exacerbated by increasing industry and regulatory complexity and can be further intensified when SMID-cap companies have underdeveloped policies, procedures, and governance infrastructures. This increase in workload has led to some boards questioning whether their compensation programs appropriately reward directors for their time, and whether increases in pay or one-time awards would be reasonable.

There are certain legal sensitivities around board compensation which are beyond the scope of this article, so companies should seek proper counsel prior to making any changes. However, below, we discuss several strategies that a company can consider to enhance the alignment between director compensation and their contributions to the company.

Peer Group Selection and Pay Positioning

Driven by innovation and technology, many SMID-cap growth companies operate in more speculative areas of the industry. And when there are new technologies, there is often greater regulatory complexity. Together, these factors require a diversity of skills and experience on the board that goes beyond what is typical. This circumstance shines a brighter light on peer group selection to ensure that it is truly reflective of business complexity and board-level talent needs. Thinking creatively about the peer group will therefore provide an appropriate baseline with which to set board compensation.

Once the peer group has been reaffirmed, the board should also consider pay positioning relative to the group. If supported by pay levels among the peer group, the board can reasonably increase compensation to a higher percentile of the market while keeping one eye on the aggregate dollar value relative to any director compensation limits in the equity plan. Note that any changes in pay positioning may also have implications for executive compensation (since many companies seek alignment between board and executive pay positioning strategies) and that changes should be thoroughly disclosed and rationalized in the proxy statement. Adjustments to peer group and pay positioning are most appropriate if increases in board workload and complexity are expected to be permanent.

Special Committee or Consultant Compensation

Increases to workload or complexity are sometimes anticipated because of a special situation such as a transaction. In these cases, companies can consider forming a special committee (or subcommittee) to handle the project and provide incremental compensation for the work. Pay practices vary but typically involve an additional cash retainer of between $20,000 and $25,000 and occasionally additional equity compensation. Out of 38 “special committees” formed over the last three years at companies with between $350 million and $1.5 billion in annual revenues, we found the median member and chair cash retainer to be approximately $25,000. Only one provided incremental equity compensation.*

If the anticipated workload is expected to affect only one board member and the work has an unclear timeline, companies could consider entering into a consulting agreement with a director to compensate them hourly. Hourly consulting arrangements have the added benefit of tying compensation earned directly to time spent but can raise governance concerns if caps are not set on the total compensation that can be earned under the arrangement. As such, boards should define pay limits and time periods beyond which consulting agreements cannot extend without board approval. Companies must also remain cognizant of total compensation (i.e., the sum of compensation for regular board service plus the sum of consulting fees) to ensure that it remains reasonable.

One-Time Awards

A company could consider one-time ex post awards to recognize extraordinary director contributions in certain situations. Since compensation is being awarded after-the-fact, there’s a built-in advantage in that companies have a much better understanding of the extent of the work conducted and its impact on the company. They may, therefore, be in a better position to place a value on the work provided. However, there’s no denying that one-time awards—and particularly off-cycle awards—raise the biggest red flags with shareholders and proxy advisors and increase the overall risk associated with director compensation. Once again, one-time awards should be evaluated in the context of total board pay to ensure that compensation in the aggregate is reasonable and consistent with peers.

Conclusion

Increasing demands on directors' time has led many boards to question the appropriateness of their compensation program. Legal sensitivities around board compensation mean that companies should seek proper counsel before making significant changes. However, with proper peer group selection and creative design, we believe a more tailored approach to compensation is not only possible but critical in certain situations so that companies can attract and retain the best directors available.

**Source: Main Data Group*

About the Author

Rob has 15 years experience in executive compensation and finance, specializing in life sciences and technology—especially emerging, high-growth companies navigating M&A and IPOs.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.