Pearl Meyer

ASK THE EXPERT INTERVIEW | APR 2024

Understanding the Norms for Private Biopharma Board Compensation

Joe McNeal

MANAGING DIRECTOR

Private companies—and private biopharma companies in particular—have unique needs when it comes to a board of directors. Compensation for those directors, who may have very specific and very helpful expertise or experience, can be complicated by situations like a not-yet-profitable pre-commercial stage or various states of capital funding. Below are common questions that we receive from clients wanting to ensure they are meeting market expectations and norms, as well as appropriately compensating for the board's time and guidance.

Q: What are the core components of board compensation at private biopharmas, and how do they evolve as the company develops?

Joe: First we should clarify that for the vast majority of private biopharma companies, only non-employee, non-investor directors are eligible to receive compensation. The thinking goes that directors representing an investment fund have sufficient "skin in the game" and they are typically restricted from receiving compensation by the funds they represent.

For all other directors, one consistent element for a privately held company from seed stage all the way to IPO is an equity component. This typically is a stock option award issued at the time of appointment to the board with vesting over a three- or four-year period. Often, the vesting schedule aligns with the vesting schedule used for employees and executives at the company.

The second element we often see is cash compensation, which is typically delivered in the form of a quarterly retainer. Among early-stage companies (think Series A and earlier), a cash component is fairly unusual. But once a company has gotten through a Series B or Series C financing, it's more common to see a modest annual cash retainer in the $25,000 to $35,000 range. Another trigger that often leads a company to begin offering cash compensation to independent board members is when one or more directors with public company experience are appointed. An example that we routinely see is a company bringing on an independent director with public market experience to serve as audit committee chair, and the chair will negotiate a cash stipend as part of the service agreement. In situations like these, a similar form and magnitude of cash retainer would then be extended to other non-employee, non-investor directors serving on the board.

Q: How should companies think about equity compensation for their outside independent directors? Is it at the time of appointment only, or is it normal to provide refresh awards from

time to time?

Joe: The vast majority of early-stage companies focus their compensation strategy on stock options. With an illiquid stock and uncertainty around the company's valuation, the anchoring metric used to size an equity grant is typically an ownership percentage calculated on a fully diluted basis. So, while this may make communicating the potential economic value of the equity challenging, it does give the participant some certainty as to the percentage of the company they will own at time of appointment. Being clear about this opportunity with incoming independent directors is important for setting the stage appropriately.

In terms of potential "refresh" or "top-up" awards, we typically see companies take a consistent approach where employees, executives, and board members are treated similarly. So, for organizations that build in a "refresh" cycle on the back of a financing, the methodology and philosophy that underpin the approach for refresher awards issued to employees and executives would similarly apply to eligible board members.

In practical terms, this would typically be a balance of how much dilution stockholders and optionees experienced in the most recent capital raise, the magnitude of the share pool replenishment that would have occurred in conjunction with the financing, and market equity ownership benchmarks.

Q: With respect to board chairs, what contributes to the wide range of equity ownership that we see in the market? Is there a way to think about board chair equity relative to non-chair board members?

Joe: This is a topic where we've seen a fair bit of evolution in market dynamics over the last few years, which I think is due to a dearth of qualified directors willing to commit the time to serve in the role relative to the number of companies that need the role.

When structuring compensation arrangements for a non-executive board chair, a good starting point is to think about the premium commonly utilized by publicly traded biopharma companies. A typical board chair premium at public companies is approximately two times the normal compensation package provided to other non-employee directors. The other feature worth mentioning is that at public companies the two-times premium is almost always delivered in the form of a supplemental cash retainer that augments the total cash paid to the board chair role.

For private companies however, the general rule-of-thumb for board chair compensation is more in the two to three times standard compensation range relative to other non-employee board members. Interestingly, we more commonly see this premium package delivered in the form of equity, which means that the ownership level for the board chair can be double or even triple the magnitude of other non-employee directors.

Q: What about advisory board members? We know that market data is patchy, but are there any general rules-of-thumb when

structuring compensation arrangements for them versus regular board directors?

Joe: This is a question we receive quite often but unfortunately reliable market data is elusive. Therefore we often utilize the existing arrangements (if any) for non-employee directors who serve on the board of directors and then apply a “discount” or differential to those provisions based on anticipated time commitment.

In their simplest form, these arrangements might include an hourly or daily rate that is paid in cash and reflects no more than two to five days of involvement with the company per year. For companies that anticipate using the advisors on a more ad hoc basis, it’s not uncommon to see a modest cash retainer of $3,000 to $5,000 per quarter, paired with an option grant that vests over the anticipated period of service. In terms of the magnitude of those equity awards, a good rule-of-thumb is to target approximately 25% to 50% of the equity ownership level provided to non-employee (independent) directors serving on the board.

About the Author

Joe McNeal is a managing director in Pearl Meyer’s executive compensation consulting practice. Joe advises management teams and compensation committees on a broad range of issues and has deep expertise in the high technology and life sciences sectors. His clients range from early-stage startups to Fortune 500 companies.

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.