Pearl Meyer

ADVISOR BLOG | MAY 2018

Benchmarking Board of Directors Compensation at Private Companies

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While there are multiple reliable sources of information on non-employee director pay at publicly-traded companies, data on non-employee director pay at private companies—both for profit and nonprofit—is more difficult to come by. Private companies therefore tend to struggle to determine the most appropriate pay levels for their directors without a strong basis in external data from similar organizations.

Further complicating the non-employee director pay question at private companies is the fact that it varies substantially based on its type of ownership (e.g., family-owned, private equity-owned, not-for-profit, etc.).

The starting point for determining how to pay directors at private companies is typically identifying the "market for director talent" for the organization. Many private companies today find that they are trying to attract the same director talent as publicly-traded companies. Just like public companies, private companies need high-caliber director talent to help the organization achieve its business goals.

The basis for many private company director pay decisions, therefore, tends to be the more readily available public company director pay information. This information can be obtained through either surveys which focus on director compensation (e.g., the Pearl Meyer/NACD Director Compensation Report) or through an analysis of the proxy statements of a peer group of publicly-traded companies. (This will typically be the same peer group which is used to analyze the competitiveness of senior executive pay.) The data cuts from surveys are selected as those most relevant to the private company based on size and industry characteristics. If peer group data is used, the peer group companies will also reflect the size and industry of the private company.

Once the appropriate data cuts have been selected, private companies then analyze the various components of director pay, including:

- Annual cash retainer and meeting fees for board service
- Total cash compensation for board service
- Annual equity retainer for board service
- Total compensation for board service
- Annual committee chair and member retainers and committee meeting fees
- Total cash compensation for committee service
- Total compensation
- Additional retainers for board chairs and/or lead directors

Private companies tend to target their non-employee director pay at around the median of total cash compensation (excluding equity retainers) of publicly-traded companies. This approach results in competitive cash compensation but well below market total compensation due to the lack of an equity grant, which in publicly-traded companies generally comprises just over half of total compensation.

Most organizations believe this below-total compensation positioning is appropriate for a private company for the following reasons:

- Public companies are subject to substantial additional regulatory oversight and disclosure requirements which are not mandated for private companies (e.g., SEC and stock exchange regulations, Dodd Frank, Sarbanes Oxley, etc.), and which add significant complexity to public company director roles.
- Due to disclosure requirements, public companies are subject to greater external scrutiny from regulators, shareholders, proxy advisors, and the press than private companies—as well as greater liability risk—again adding to the complexity of director roles.
- Public companies typically seek to align a meaningful portion of director pay to returns to shareholders through annual equity grants. These equity awards, generally not available to directors of private companies, drive up overall pay at public companies versus similarly-sized private companies.

While small nonprofit organizations typically do not pay their directors (or trustees), very large nonprofit organizations often do pay their directors and adopt an approach similar to that described above for other private companies, although nonprofits will sometimes adopt a more conservative competitive positioning than other private companies (e.g., targeting their total director pay between the market 25^{th} and 50^{th} percentiles of similarly-sized public companies in their industry).

Overall, the lack of reliable private company director pay data has resulted in organizations applying their best judgement to available public company director pay data to design an appropriate director pay program which is reasonable in level while also ensuring that the board can attract and retain qualified and dedicated director talent.

About the Author

Ed Steinhoff is a managing director and consulting team leader at Pearl Meyer. In his management role, he oversees a team of senior compensation consultants in the execution of the firm's growth strategy and in the development of consultants at various stages in their careers. With more than 25 years' experience in executive compensation, Ed works with the boards of directors and senior management teams of public and private companies, ranging from small and middle-market firms to multibillion-dollar corporations, to design pay programs that drive business performance and value creation, secure high-performing executive talent, and meet both regulatory standards and stakeholder expectations.

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