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Setting Pay for Directors at Growing Private Companies

By Bob Romanchek and Ed Hauder

Growing private companies need to carefully consider how to best establish pay for their independent directors. Private companies should consider several items when doing so, including where the company is in its business cycle, how the company is performing compared to market peers, and what skills new directors will need to assist the company in achieving its strategic goals and objectives. Additionally, if a public offering is planned for the near or intermediate term, the director pay package will need to eventually transition to public company practices in its size and design.

For board pay at private companies, the one component that is different in form and magnitude from public companies is equity grants. Even if a private company has equity available for grants, generally they are quite modest in comparison to public company equity grants. Ultimately, private company director pay tends to be significantly lower than public company director pay due to significantly lower equity grants.

When a growing private company decides that it needs specific skills and abilities for its next group of directors, and those skills are also in demand by public companies, care must be taken in setting director pay so that it isn't a hindrance to attracting talented and skilled directors.

Since many private companies may not be able to offer significant equity grants to directors to help bridge the gap between current pay levels and externally competitive pay levels, these companies will need to get more creative in their efforts.

Firstly, a private company should analyze its annual cash retainer to see how it compares to those offered by similarly sized public companies. There is often room for a private company to increase its cash retainer or meetings fees, which would cause overall director pay to be more competitive against public company pay.

Secondly, a private company should evaluate how the chair and member fees for its various board committees compare to those of similarly sized public companies. Again, there likely will be room for a private company to increase those chair and member fees so that the overall director pay program can be more competitive.

Finally, a private company should consider granting derivative equity awards that are settled in cash rather than shares. For example, a private company could grant restricted units whose value is based on the company's book value. Typically, these restricted units would be subject to a multiyear vesting period. Upon vesting, a director would receive a cash amount equal to the number of units vested multiplied by the company's per-unit book value. This makes the restricted units similar to the restricted stock units granted by public companies.

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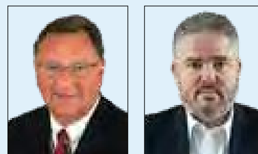
Growing private companies that find they need directors with the knowledge and skills only available to public company directors, executives, or former executives in similar industries to the private company may need to reevaluate their director pay programs. These entities will need to ensure that their pay package is competitive and does not present an obstacle to attracting and convincing potential directors to consider serving on their boards. If the director pay program is viewed as competitive with similarly sized public companies, it shouldn't present as a roadblock to attracting the talented and skilled directors needed. Comparing director pay to that of an appropriate peer group of public company directors provides an aspirational target for compensation levels and program design, where data are readily available. D



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