Pearl Meyer

ADVISOR BLOG

Are Today's Directors Underpaid?

AUTHOR

Michael Esser
Managing Director

Over the past several years, the complexity and time commitment associated with board membership has increased significantly, due to an expanding remit that includes monitoring and oversight of:

- Environmental, social, and governance (ESG) issues;
- Diversity, equity, and inclusion (DE&I) initiatives; and
- Human capital, talent management, and leadership development.

The scope of these issues has impacted the full board and in particular compensation committees, now frequently charged with a broader purview which is often reflected in an updated name, e.g., the human capital or the talent and compensation committee. These expanded responsibilities are also changing what it means to be an effective director.

Yet while the great resignation, inflation, and a competitive market for talent has lifted compensation levels more broadly over the past few years, director compensation has not kept pace. One could argue that today's directors are underpaid, especially given their expanded roles.

There may be several reasons why director compensation has increased at a slow pace, including:

- **Greater scrutiny**—while director compensation levels have been reported in the proxy for some time, in recent years, shareholder advisors have been monitoring and flagging outliers as "excessive." In addition, analyses of peer organizations are often used as context for setting director compensation levels. The combination of greater scrutiny and peer analyses has resulted in a compression of the "market range" (25th to 75th percentile) for director compensation.

- **Directors set their own pay**—while one might think this would result in a bias toward higher pay or increases, the opposite is true. In our experience, boards are generally circumspect when it comes to pay, and avoid large increases that are not supported by the data. At the end of the day, directors are very mindful of their duties to shareholders in this regard.

- **Equity grants are constrained**—equity grants to directors are generally denominated as a fixed dollar value, rather than a fixed number of shares or options. This constrains any increases that are solely a result of increases in stock price, as the dollar value of grants remains the same or increases only incrementally, similar to cash compensation.

So how do we address this increasing gap between director responsibilities and lagging pay levels? Following are some initial thoughts:

- **Consider a onetime adjustment to board compensation—**conduct a review of director compensation levels relative to your peer group or the NACD survey data, and consider whether a onetime adjustment is needed to account for the increased time and responsibilities of today's directors. Some questions to ask:
    - Has your board's remit truly expanded, especially with respect to oversight of ESG and DE&I issues?
    - Has the amount of time associated with board or committee meetings increased significantly? Virtual meetings were a necessity during the pandemic and can be efficient/effective as an ongoing practice; however, they may have a tendency to proliferate, especially if there is more subject-matter ground to cover.
- **Don't forget to review committee compensation—**the impact of expanded responsibilities is often most acute on the committee level, especially on the compensation and governance committees. Consider whether committee chair and member retainers—and their relationship to other committees—adequately reflect this new time commitment.
- **Consider evaluating the time commitment required of board members**—Gather information regarding the time associated with each committee and full board meeting, including pre-reads, preparation, and follow-up items or meetings. We're not suggesting a "timecard" approach; however, having more data will help establish a baseline and provide another point of triangulation to consider when setting compensation levels.

The Pearl Meyer/NACD Director Compensation Survey as well as custom peer-group analyses provide an excellent resource and data-grounded context for setting board pay. However—like all analyses—the data lags the current marketplace and trends take time to show up. Given the rapid evolution and expanding responsibilities of board membership, it may be time to consider "bridging the pay gap" sooner rather than later.

About the Author

Mike Esser is a managing director at Pearl Meyer. Mike has more than 25 years' experience as an advisor to boards and senior management in executive and board compensation, compensation strategy, and annual and long-term incentive/equity plan design. His consulting experience covers a variety of industries and company organizational and developmental stages, including startup/pre-IPO, privately-held, public, cooperatives, and non-profit organizations.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, New York, and San Jose.

Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.