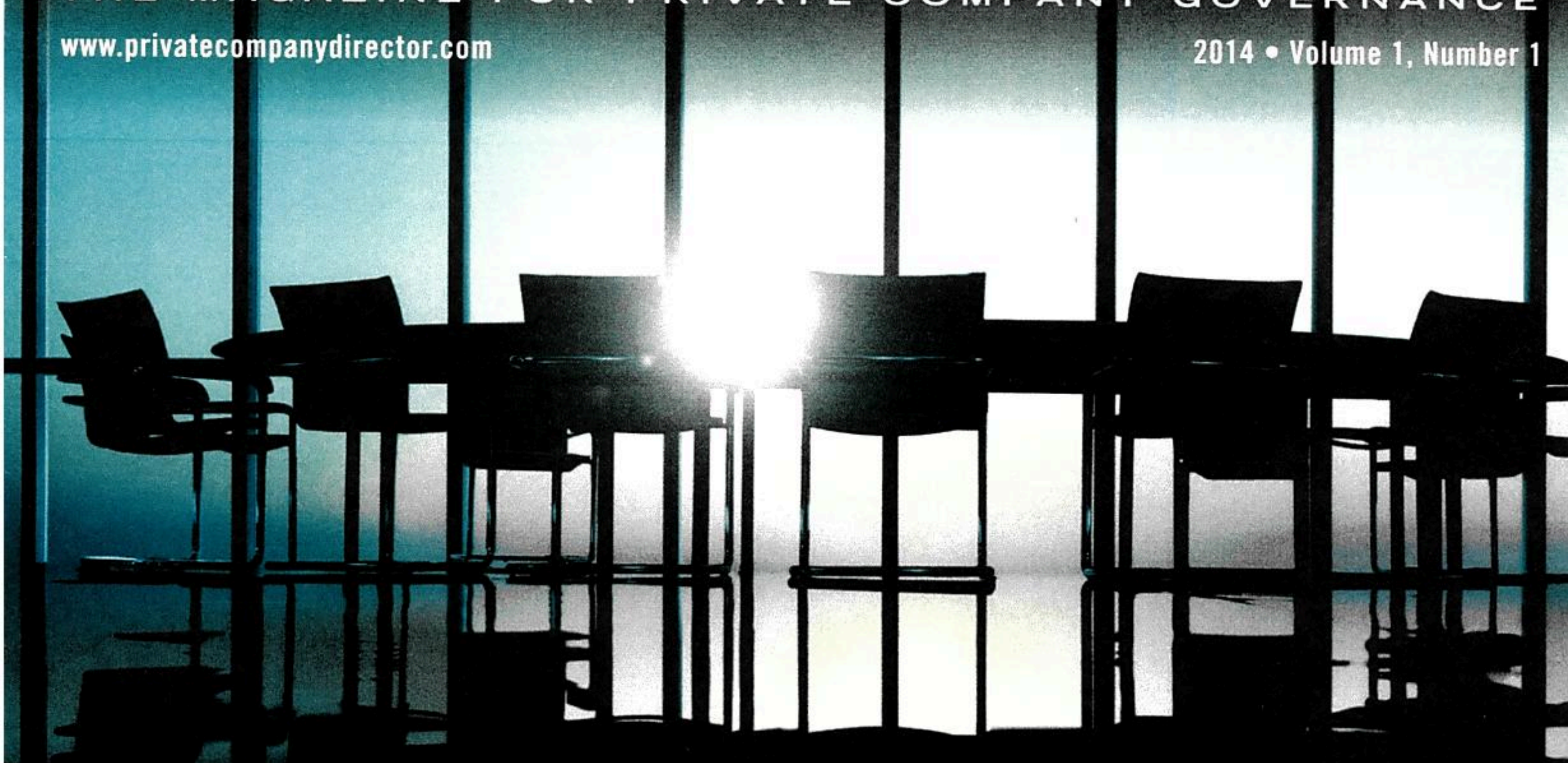
PRIVATE COMPANY DIRECTOR

THE MAGAZINE FOR PRIVATE COMPANY GOVERNANCE

www.privatecompanydirector.com

2014 • Volume 1, Number 1



PREMIERE ISSUE!

THE PRIVATE COMPANY GOVERNANCE SUMMIT 2014

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Private Board Composition, Evaluation and Compensation

A primer on building, evaluating and compensating the private company board.

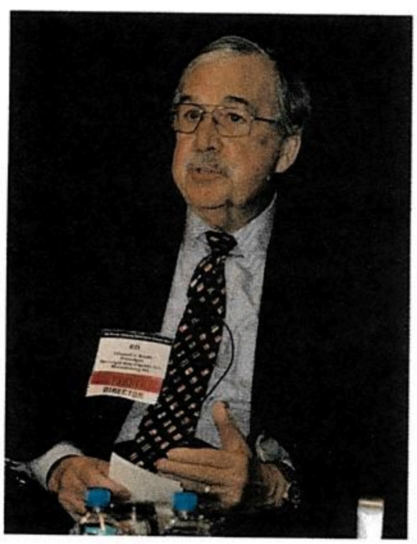
By Jim Kristie

The magic number is $30,000.

That seems to be the generally agreed-upon compensation fee being paid in the marketplace for a private company director, according to Bernard H. Tenenbaum, managing partner of board consultancy Lodestone Global. Through his close ties with the Young Presidents Association, Tenenbaum has some of the best data on director compensation for private companies, drawing as he does from YPO surveys of its board members.

The accompanying exhibits offer a fuller breakout of board compensation for private companies, presenting on an average and median basis what fee structures look like for annual retainers, in-person meeting fees and teleconference fees. At a $30,000 yearly rate, Tenenbaum hinted that private companies seemingly are getting a bargain compared with their public company counterparts, whose fees average over $100,000 (see BDO 600 data in Exhibit 2).

Tenenbaum, who also wears the hats of corporate director and advisor for both public and private companies, was a key member of the panel on "Private Board Composition, Evaluation and Compensation" that closed out the 2014 Private Company Governance Summit. His fellow panelists were Edward J. Smith, president of Barnegat Bay Capital Inc., and Gary Sutton, who has served in management and board positions for many companies in his career as a specialist in corporate restructuring and turnarounds. John Wood, vice chairman of Heidrick & Struggles and global managing partner of the recruitment firm's Chief Executive Officer and Board of Directors Practice, moderated the panel.



"You are going to get what you pay for," Tenenbaum advised the PCGS audience in reviewing his compensation data. Many private companies can't or won't step up to the plate and offer big-league retainer and meeting fees—perhaps trying to get by with a $500 a day honorarium or other cut-rate fee—but Tenenbaum made the compelling case that private company directors are worth much more for the contribution they can make to the sustainability of the enterprise.

That value factor becomes clear as Tenenbaum addressed, "Who should be on my board?" Here is his answer:

- *Someone who know things you don't.* (And that doesn't mean your lawyer or accountant.)

EDWARD J. SMITH, PRESIDENT, BARNEGAT BAY CAPITAL INC.: "A 'PEER REVIEW LITE' PROCESS MIGHT BE TO ASK EACH DIRECTOR FOR THREE THINGS THAT [FELLOW DIRECTOR] DOES WELL AND THREE THINGS THAT THEY'D LIKE TO SEE [FELLOW DIRECTOR] DO BETTER."

EXHIBIT 1 PRIVATE DIRECTOR COMPENSATION

Source: Lodestone Global

U.S. Data	Average	Median	2012
Annual Retainer	$14,158	$20,000	$20,000
Per Meeting Fee	$1,479	$2,500	$2,500
Per Teleconference	$939	$1,000	$750
Total Compensation	**$21,952**	**$32,000**	**$31,500**

International Data	Average	Median
Annual Retainer	$16,675	$20,900
Per Meeting Fee	$2,153	$1,250
Per Teleconference	$1,250	$1,250
Total Compensation	**$27,778**	**$28,400**

- *Someone who has perspectives different than yours.* (That means limiting insiders on your board.)
- *Someone who will challenge your assumptions.* (That is definitely not your friends and family.)
- *Someone who has already been there.* ("No rookies!")
- *Someone with experience in related industries.* (For example, if you're in the warehousing business, you might target someone from a relevant segment of the transportation industry.)
- *Someone with better connections than you have.* (You want access to excellent networks.)
- *Someone who has already solved your problems.* ("It reduces the fear of the unknown" ... and this: "If your goal is $100 million in sales, find another CEO who has grown through that level").
- *Someone with a strategic perspective that will add value.* ("There is nothing like a big set of binoculars to see what's coming up next.")

Other candidates you might consider, Tenenbaum said, are a deals expert (if growth is on your agenda); an international markets expert; a "token academic" (often to be found, he says, in business and engineering schools); and a prominent name (for "dressing up" your board). And, for sure: a great manager—"as long as they don't think they are always right."

Ed Smith followed up Bernie Tenenbaum's recommendations on board compensation and composition with a forceful recommendation of his own: boards should evaluate their own performance.

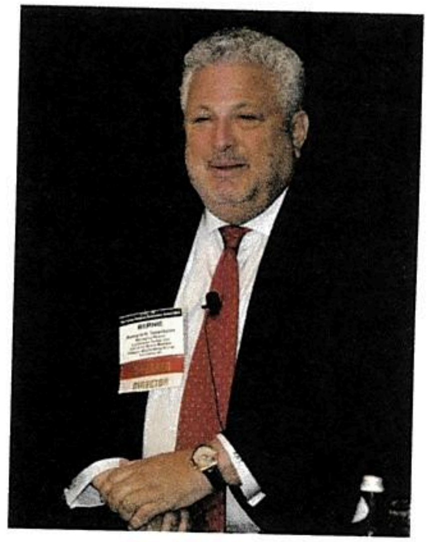
EXHIBIT 2 PUBLIC DIRECTOR COMPENSATION

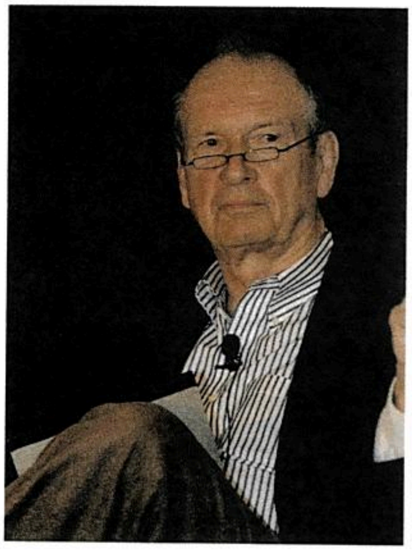
U.S. Data	Average
Board Retainers and Fees	$43,292
Committee Retainers and Fees	7,422
Full Value Stock Awards	32,005
Stock Options	19,445
Total Compensation	**$102,164**

Source: 2012 BDO 600 Survey

Smith has had significant board experience. He has served on several corporate boards, and is involved with the National Association of Corporate Directors as a Leadership Fellow and faculty member of its board advisory services. As president of Barnegat Bay Capital Inc., he provides corporate governance advisory services to boards and management of public and private companies and nonprofit

BERNARD H. TENENBAUM, MANAGING PARTNER, LODESTONE GLOBAL: "DON'T BE CHEAP! A PRIVATE COMPANY DIRECTOR WHO IS A TOP TALENT IN HIS OR HER OWN RIGHT WILL BE WORTH MULTIPLES OF WHAT YOU'RE PAYING THEM."





Gary Sutton, Director, Procuro:
"It is unfair to the employees if directors aren't reviewed once a year."

organizations.

Smith walked the audience through the process of a board evaluation, which is most often done via a questionnaire that is circulated to the entire board. The questions may have a numerical range for answers, but Smith strongly suggested that you try to get "comments on the questions that add value," adding, "What you really want to get at is where we can do better."

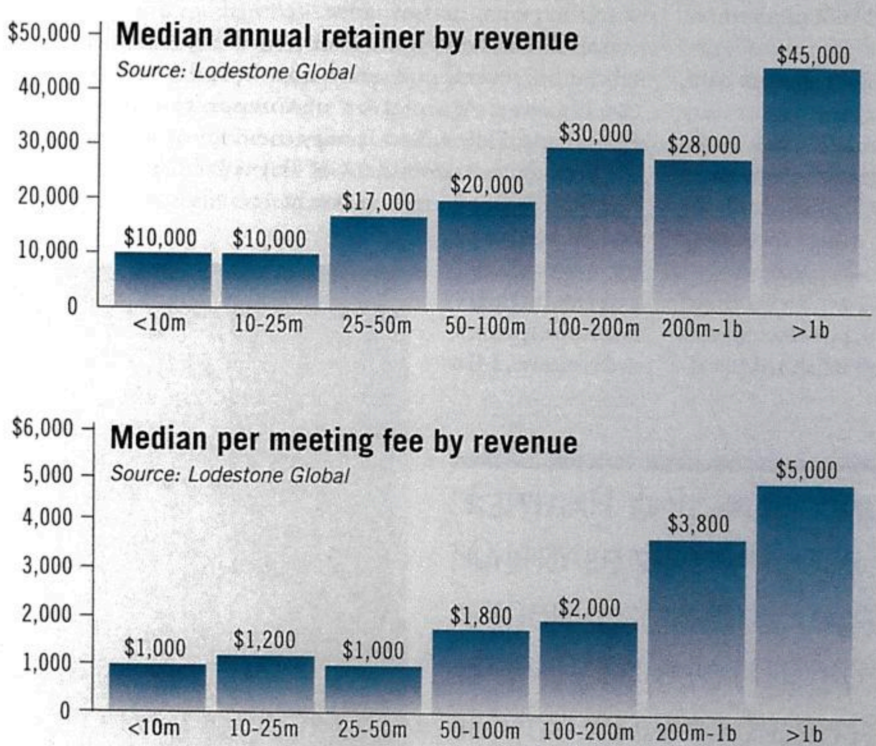
Another form of board evaluation might be a peer evaluation, which Smith acknowledged can be "terrifying" for the board members to partake in. But it needn't be. As he explained it, "A 'peer review lite' process might be to ask each director for three things that [fellow director] does well and three things that they'd like to see [fellow director] do better." The key is that only the director sees the evaluations, not the CEO or the nominating and governance committee. This builds trust among the directors, contributes to a more efficient functioning of the board, and may activate an underperforming director to submit his or her resignation.

Addressing the concern that board evaluations may give rise to liability, Smith acknowledged that this is of less concern in private companies. What he recommends is documenting in the board minutes that you have done or will do a board evaluation.

"It is unfair to the employees if directors aren't reviewed once a year," added Gary Sutton, the third member of the panel. Sutton has an extensive corporate background, serving in the early part of his career with Honeywell International before carving out a niche as a turnaround expert. (One of his books, in fact, is titled *Six-Month Fix.*) He has held a number of CEO and board positions and is currently a director of privately held Procuro Inc., AgileNano Inc., Social Fabric, and LightSource Renewables LLC, among other enterprises. He has also been a columnist for *Directors & Boards.*

Being so focused on performance issues as is his nature, Sutton strongly approved of a director evaluation process, especially one done by an outsider because that evaluator might then better "validate" if there is a problem with a certain board member's performance. "Firing a director is delicate surgery," Sutton cautioned. Using outsiders to do board evaluations, which he said he has had good luck with, "depersonalizes" the process.

EXHIBIT 3 PRIVATE BOARD PAY



HOW MANY INDEPENDENT DIRECTORS DO YOU NEED?

Bringing on independent directors is really about lowering the risk for the family owners.

Ideally, private firms still under full ownership of the family should have two to three independent directors; having just a single outsider is too isolating for that one director, and a minimum of two is needed to truly affect board dynamics. For public companies — whether still majority family-controlled or with the family being a large but minority shareholder — independent directors should form the majority of the board in order to represent the full range of interests.

There are nuances to this formula. In companies with one large or supervoting single shareholder, it's less important to have independent voices on the board. If the controlling shareholder wants to run things his or her way, he's the one with most at stake. But if a company has a much more diffuse and geographically dispersed group of family owners, a plurality (vs. a majority) of independent directors allows for enough unbiased perspective to come through.

—*John Wood, "Independent Directors for a Family Business,"*
Directors & Boards, *First Quarter 2011*

In terms of recruiting new members to a board, Sutton's prime recommendation was that this task not be left solely up to the chief executive. In one of the strongest warnings offered by this panel, Sutton laid out the danger of a CEO handpicking a new board member: what then happens is that a "bloc" has just been created on the board formed by the CEO and his or her board designee. "That is a board I would never go on," he stated.

John Wood of Heidrick & Struggles deftly moderated the spirited panel. He acknowledged that an "extra dose of personal credibility" is often needed by independent board members to overcome family dynamics. And he advised that there should not be just one independent director on a private company board, particularly one that is family-controlled. "My opinion is you need two to three more voices in order to be effective," he says. In an article he wrote for *Directors & Boards* (see sidebar), he offered additional guidance on the composition of a private company board.

If the audience left this final panel of PCGS 2014 with one overarching piece of advice for having a quality board, it was Tenenbaum's plea: "Don't be cheap!" A private company director who is a top talent in his or her own right and can help you accomplish your objectives for long-term sustainable success will, he said, "be worth multiples of what you're paying them." ■