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ADVISOR BLOG

Is it Time to Change Tradition? Not-For-Profit Board Compensation in a New Age

AUTHOR

Bill Dixon
Managing Director

By tradition, directors who are asked to "volunteer" to serve on the boards of tax-exempt organizations are very rarely offered any form of compensation. Most surveys place not-for-profit board pay prevalence at less than 15%, most of which is at health plans and foundations.

Based on our experience, the prevailing rationale is that these board members do not need compensation. In fact, many directors are expected to give not only time, but to also donate their money—or help raise funds—as part of their service. Further, the Internal Revenue Service has taken a dim view and has discouraged not-for-profit board remuneration, without overtly prohibiting it. A combination of these two factors has limited the adoption of what is a nearly universal practice in public and private "for-profit" companies. It's safe to say that in this area, "good governance" practices vary dramatically.

However, there are several sound business and governance reasons for some not-for-profits to reconsider tradition. Given current societal, governance, and public perception trends, there is an increasing call overall to change the makeup of boards—to move to board composition that is more representative, diverse, and inclusive. At the same time, there has been a continual escalation of risk associated with being on boards. Offering compensation for board service could be a beneficial way to help organizations attract a broader population of exceptionally talented people who normally would not be asked to serve. Paying them demonstrates the organization's interest in elevating its board and the value placed on its time and expertise.

There are other reasons to consider compensation for not-for-profit board membership and service:

- It can attract a broader candidate pool with more economic diversity—and thus diversity of experience and perspectives—versus traditional recruitment methods;
- Paying someone to serve engenders greater accountability, preparation, and meeting attendance, which can be an issue, in these organizations;
- It rewards the professional expertise that individuals bring to the board;

- It can reduce the potential for real or perceived conflicts of interest; and
- It is, in fact, legal and compliant of regulations to do so—it just must be done correctly.

For organizations that choose the path to design and implement a director compensation program it is very important to avoid a few legal and regulatory pitfalls. The first thing a board must review is its own bylaws and charter to see if it is permitted. Next, consider the perceptions of donors, supporters, public stakeholders, and other external "optics." Then, the organization must analyze and follow IRS regulations, including "Intermediate Sanctions" rules surrounding "reasonable" compensation, private inurement guidelines, and state laws. Finally, the ideal compliance process should be followed under the Intermediate Sanctions rules noted above.

In my experience, devising an effective and compliant board compensation process can be done in a way that achieves new objectives and passes external scrutiny. Now may be an ideal time to consider the idea.

About the Author

Bill Dixon has more than 40 years' experience in the field of executive and board compensation, total rewards, and human capital management. He has specialized expertise in the healthcare and insurance industries and with not-for-profits and higher education institutions. He has also helped numerous public and private organizations undergoing a merger, spin-off, or acquisition.

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 and FTSE 350. The firm has offices in Atlanta, Baltimore, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.

Pearl Meyer

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

BALTIMORE
(410) 494-4100
baltimore@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

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

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

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

RALEIGH
(919) 644-6962
raleigh@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.