



DIRECTOR COMPENSATION in nonprofit healthcare organizations

Whereas virtually all commercial corporation boards compensate their members, it's estimated that only 20 percent of nonprofit healthcare systems and less than 10 percent of nonprofit hospitals do.

Whether directors of nonprofit healthcare organization should be compensated is a controversial topic that stimulates passionate debate. I don't have a general recommendation. The reason: local sensitivities, in addition to organizational context and contingencies/constraints, vary considerably and must be taken into account.

All boards should undertake a serious examination of the compensation issue, deliberate the assets/liabilities in light of their own situation/circumstances and then make a decision. Here are some of the key pros and cons.

the pros

- Directors add significant value on behalf of the community and to the organization. Compensation is a tangible way to recognize and reward such contributions.
- The amount of time/effort and work required of healthcare organization directors far exceeds that associated with serving on most other nonprofit organization boards.
- Directors incur both opportunity and indirect costs associated with board service. Compensation is a means to cover and reimburse some of these costs.
- Compensation reinforces the importance and seriousness of serving on the board.
- Compensation makes it easier to attract, retain and motivate the very best talent who are always busy people in great demand.
- Compensation stimulates higher levels of attendance at board and committee meetings.
- The board can expect much more of directors when they are compensated.

the cons

- The vast majority of nonprofit organizations don't compensate directors. In doing so, one is "going against the grain," which attracts attention and warrants answering the question: Why are we so different?
- Compensating directors reinforces the increasingly prevalent notion that nonprofit healthcare organizations are no different than commercial enterprises and should be treated accordingly in matters such as taxing property.
- The amount that most healthcare organizations are willing to pay directors would not make an appreciable difference in attracting or retaining the most able individuals, increasing meeting attendance and stimulating participation. "The chew is not worth the bite."
- Director compensation is ill-timed given constant pronouncements regarding the inadequacy of third-party reimbursement in addition to marginal increases in pay and benefits provided to employees.

- Commercial corporations compensate directors. Healthcare organization board service is no less important and demanding. Fair is fair.
- Directors are typically successful people who, because of their involvement in a wide variety of business and civic activities, have many competing demands placed on them. Compensation is one way to focus director attention on their governing duties.
- Compensation (particularly when its more than nominal) forces boards to get serious about new member recruitment/selection in addition to director assessment and reappointment.
- Nonprofit healthcare organizations are corporations valued in the hundreds of million, or even billions of, of dollars. They can afford to compensate directors. Not doing so is "penny wise and pound foolish."
- In general, organizations get what they pay for.
- Most present and prospective directors consider board membership a community service; therefore, they neither want nor expect to be compensated. Doing so might offend the very individuals whom the organization wants to attract and retain.
- When serving as organizational representatives and advocates, compensation could compromise director credibility. Their message might be perceived to have an implied disclaimer: "This is a paid endorsement."
- Other individuals volunteer large amounts of time to healthcare organizations. If the board is compensated and they aren't, some might ask: "Why are we being treated differently?"
- In some states, nonprofit organization directors are partially protected from personal liability, but only if they are unpaid. Compensation could jeopardize this indemnification.

If the board decides not to compensate directors, this decision should be revisited about every three years.

If a decision is made to compensate directors, consider the following design principles and associated observations/recommendations:

- Be explicit, precise and forthcoming about compensation program objectives.
 - The only legitimate rationale for director compensation is that it will enhance board performance and contributions, thereby increasing stakeholder value.
 - Be proactive (rather than reactive, defensive or evasive) in announcing the program to the community and stakeholders. Have a well thought out and crafted message.
- Carefully weigh alternative compensation structures.

The most widely employed options are: a yearly retainer; and a fee based on board meeting attendance. A yearly retainer plus board meeting attendance meeting is probably the most effective arrangement. The retainer reinforces the importance of governing work in addition to rewarding talented and in-demand individuals for serving on the board. The per-meeting fee compensates directors for their time.

- Determine whether the chair should receive compensation in addition to that provided other directors.

I recommend they should. Indeed, a strong case can be made for compensating the chair in the absence of doing so for all directors. The board chair is a critical leadership position that, when performed well, requires considerable time and skill. In many instances, compensation makes it a bit easier for busy and talented people to assume this role when asked to serve.

- Decide whether some or all committee chairs should receive a compensation differential.

For the sake of simplicity, I recommend they do not. If a decision is made to pay committee chairs, a host of tricky questions arise: Should all committee chairs be paid the same? Clearly some committees are more important, meet more frequently and their chair roles require much greater work than others. When *ad hoc* committees are formed, should their chairs be compensated and how should this be determined?

- Be clear about what class of directors shouldn't be compensated.

I strongly advise not compensating *ex officio* directors who are separately paid by the organization for the position which results in their appointment to the board. *Ex officio* directors are appointed to a board automatically, by virtue of bylaw provisions, due to other positions they hold (either with or without vote). Typical examples are the CEO and president of the medical staff. Thus, when these individuals receive compensation for the positions that "bring them to the board," (always for CEO, sometimes the case for medical staff officers) they should not receive additional compensation as directors.

- Set the amount of compensation so that it's more than a symbolic/nominal amount.

Often, boards decide to compensate directors and then make the mistake of setting the amount far below what is needed to accomplish their objectives (i.e., some or all of the pros noted above). The principle is: If the decision is made to compensate, do so at a level that matters to, and grabs/focuses the attention of, directors. When fees are too low, the organization/board bears all the negatives of compensation and reaps few of the benefits. I do not have specific recommendations here, as rates will vary depending on a host of factors including local circumstances/sensitivities and organizational size/complexity. Your board might want to:

- Survey other roughly comparable nonprofit organization boards in your community/region that compensate directors. Their rates should be used as a point of comparison, not a standard.
 - Rough-up figures, by selecting a range of hourly rates (e.g., \$150 - \$250 per hour, amounts that most people would not find unreasonable). Next, estimate the number of hours directors spend annually performing their roles; it's important to be inclusive ... scheduled board/committee meetings, special meetings, serving on task forces, educational sessions, board retreats, etc. ... 50 hours per year is not atypical. Hourly rates of \$150 and \$250 at 50 hours per year would produce a total compensation range per director of \$7,500 to \$12,500. The question remaining is: What proportions should be allocated to retainer and meeting attendance fees (if this structure is selected). Compensation rates should be reviewed and, if necessary, adjusted about every three years.
- If directors are compensated, their performance and contributions must be assessed. That is, a formal process must be put in place; compensation absent paying for performance is difficult to justify.

- Develop a plan for periodically (every 3-4 years) assessing the extent the compensation program is adding value and accomplishing its objectives. The question here is: What return are stakeholders and the organization getting for their investment? This is nearly impossible to quantify; but, a formal/focused qualitative assessment should be undertaken.