Pearl Meyer

ARTICLE | FEB 2022 | CHIEF EXECUTIVE MAGAZINE

Agility and The Changing Nature of Compensation



Ryan P. Hourihan

MANAGING DIRECTOR

Editor's Note: This article appeared in the February 2022 issue of Chief Executive magazine.

Executive Incentive Pay Strategies for 2022 and Beyond

Heading into year three of a global pandemic that upended work as we knew it, companies are still grappling with a business climate characterized by continual uncertainty and high risk. From supply chain disruption and inflation to the ever-escalating talent war, myriad forces are complicating the challenge of performance forecasting and goal-setting. Those circumstances have many companies rethinking their approach to incentive compensation, notes Ryan Hourihan, a managing director at Pearl Meyer.

“What we’ve seen as a result of COVID-19 is just what you would expect: that annual incentive programs are only as good as the goals you set against them,” Hourihan told business leaders gathered for a roundtable discussion sponsored by Chief Executive and Pearl Meyer. And goal-setting is particularly challenging in an environment where external factors may play a bigger role than executive performance in determining outcomes.

That proved the case for Mark Trushel, CEO of sales and management training firm Mantaline, who reported having to scratch his business plan entirely after it was derailed by the supply chain issues that emerged in 2021. “The paper wasn’t even dry before I threw it out,” he says. “We ended up lowering [goals] by 15 percent because of the uncertainty.”

These kinds of challenges have led some companies to re-evaluate the metrics in their incentive programs to reflect new business realities. Government employee insurance provider WAEPA, for example, decided to pivot away from tying incentives to sales targets, says CEO M. Shane Canfield, who noted that “last year, we couldn’t really influence sales much, so we said, ‘Let’s focus on operating profits because that’s something we can

control.' That really helped. It got people motivated, and we did quite well with it."

Other companies are opting to soften the targets being used to generate annual incentive payouts for the C-Suite. Rather than tying annual bonuses entirely to quantifiable financial metrics, a number of companies chose to incorporate discretionary individual performance metrics in determining top management's annual bonus.

"In the past, individual performance metrics in areas like ESG was something we generally saw at middle-management level and below in companies seeking a more controllable contribution at those levels," explains Hourihan. "But we're now seeing that bleed into the the upper management ranks. We think that was driven by the fact that in the beginning of the year, companies that typically incentivize on revenue growth or EBITDA saw that as a shot in the dark given the uncertainty around COVID-19. So they pivoted and said, 'Let's implement something a little more subjective.'"

Adapting to an Upswing

Forecasting is also proving trickier for companies that experienced an unanticipated—and unlikely to be repeated—boon during the pandemic. The leveling off of crisis-fueled spikes in revenues called for a corresponding downward adjustment to growth targets.

For example, buoyed by unprecedented demand for broadband access during the exodus to remote work, Consolidated Telephone Company (CTC) experienced its best-ever year in 2020, says Kristi Westbrook, the telecom's CEO. "We blew our targets out of the water—it was sheer insanity to keep up," she said, noting that the spike has since leveled off. "We're going to have a successful 2021, but it won't be 2020—and that does make it a little difficult in our target incentives for the director and above staff."

Companies making such adjustments also run the risk of shareholders and compensation committees accustomed to steadily rising growth trajectories balking at the notion of reducing goals. "There's been concern that boards might react to goals that management felt were attainable by saying, 'Wait a second, are you telling us we're going to do 20 percent worse than we did last year?'" says Hourihan. "So we're seeing a lot of tug of war at the board/management level in terms of defining goals. And it's even more magnified in the public space—it can leave a pretty sour taste in shareholders' mouths when they see targets for this year that are below last year's actual financials."

The Private Problem

Private companies are also struggling with recruiting and retention challenges in today's talent-starved business world. The need to compete with public companies for talent is prompting an uptick in the number of private companies employing long-term incentive plans, as well as design changes intended to boost their efficacy as a retention tool.

"About five years ago, slightly less than half of privately owned companies offered some type of long-term incentive—now it's about 60 percent," reports Hourihan. "Also, prior to COVID-19 and this retention issue, the equity options at most privately held firms only became accessible through a value-creating event, such as a sale, an IPO or some type of funding. Absent a line of sight to such an event—essentially no way to envision cashing out—the perceived value of the plan just craters completely for employees."

Liquidity options are one way to address that issue. Companies concerned about losing talent to the Great Resignation or to the allure of incentives public companies can provide may want to consider making one-time awards that vest over time, advises Hourihan, who notes that safeguards can be put in place to guard against such a plan becoming a financial burden. "Because cash flow can be an issue for privately held firms, we typically stagger the payout over a three-year period," he explains. "You can also include provisions in the plan document that allow the timing on payouts to be deferred if the payout will cause material harm to the company."

A Remote Recalibration

The shift to remote work is also playing a part in the need to revisit compensation practices. According to Pearl Meyer's Work From Home Policies and Practices survey, 33 percent of responding companies' total U.S.-based workforces will work remote post-pandemic.

What that shift will mean for traditionally geographic-based salary structures remains to be seen. Should companies continue to compensate employees who've left higher-cost-of-living areas for less pricey locations at the same level? How will the ability to widen their talent net nationally, or even globally, affect compensation practices?

In the near-term, competition for talent, particularly tech talent, remains far too fierce for most companies to consider attempting to bring compensation in line with cost of living for workers who've fled urban areas. "The tech market is so hot right now that I basically have companies telling me that they'll pay whatever it takes to get a worthwhile candidate in the door," says Hourihan.

However, that may change, he adds. "Right now, retention is such a huge issue that you don't want to do anything that will be viewed as a takeaway," he says. "But it will be very interesting to see how this evolves over the next 12 to 18 months and whether the hiring market dries up to the point where companies no longer have to live with the fact that they might be overpaying given where someone is residing."

As the fallout of all of these changes continues to unfold, one thing is clear: Ensuring that the links between business strategy, talent management and compensation strategy and

design are meaningful will require agility and diligence in the years to come. The lingering effects of COVID-19 coupled with changes in the availability of talent have underscored the need for companies to regularly reevaluate their compensation plan designs to adapt to the changing needs and circumstances of their businesses.

About the Author

Ryan brings 10+ years advising on incentive compensation, governance, and performance measurement across an array of organizations—with particular experience with privately held firms competing with publicly traded companies.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.