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Planning for the Next Unknown: Executive Compensation After COVID-19

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PRINCIPAL

I recently wrote about a panel discussion hosted by Sloane & Company and Innisfree M&A, part of their “Mind Your ESG” webinar series. And although the intersection of ESG and executive compensation was the focus, we find that almost all exec comp discussions are still at least touching on the impact of COVID-19. My colleague Aalap Shah and I gave a quick summary of key lessons learned from 2020 and how those are playing out with respect to goal-setting and payouts. Many compensation committees are—rightfully so—looking at the near-term implications, but we are also advising to take this one event and think about your compensation plans in the context of the next big disruption.

Consider a target range in goal-setting

COVID-19 wasn’t the first global disruption we’ve seen significantly impact executive compensation plans (e.g., 9/11 and the 2008 financial crisis), and it likely won’t be the last. To prepare for unusual events, companies may consider using a range instead of a specific goal to yield a particular payout. This approach can be a tool to ensure there is still rigor when forecasting is difficult.

Make a compelling business case for discretion/adjustments

There is an exposure risk for companies making changes without a clear-cut business case and documented, transparent process. If companies are quick to scrap goals or deviate from formulaic outcomes, it can call the integrity of an incentive plan into question. Shareholders may question the point of establishing targets if executives aren’t held accountable for falling short. With that said, incentive plans must not be so susceptible to outside shocks that they lose their motivational and retention aspects. Goal-setting and performance metrics need to reflect the business reality, and adjustments should be made rarely within certain confines and with a strict business rationale.

Apply “informed discretion”

Before taking action to adjust payouts from formulaic outcomes, companies should consider the optics and reputational risks—especially in the context of a global pandemic where shareholders and employees have suffered. An important question a company needs to answer in any crisis is: “What is the shared sense of sacrifice between executives and employees?”

A cautious return to normalcy

As vaccines are rolled out and we are emerging on the other side of the pandemic, we have observed companies return to the typical goal-setting cadence. Committees are working with management to establish challenging but achievable goals, which may be lower than previous years. This would typically invite advisory firm and investor criticism, but in an environment of continued uncertainty, investors will look for companies to be thoughtful and transparent. Overall, this is a strong position to adopt. As we move past the pandemic, but don't know what lies ahead, ongoing stakeholder communication is more important than ever.

About the Author

Stephen Huber, principal at Pearl Meyer, joined the firm in 2012. He provides compensation advisory services to public and privately-held companies, specializing in compensation market benchmarking, proxy analysis, incentive plan design, peer group development, performance goal calibration, and pay-for-performance alignment. He has worked with clients in a variety of industries, including industrials, energy, construction, chemicals, technology, consumer goods, and pharmaceuticals. He also advises clients on communications strategy and proxy disclosure.

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