Pearl Meyer

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Considerations for Board Equity Compensation Amid Depressed Share Values

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The importance of recruiting and retaining qualified board members continues to increase as boards face difficult decisions around the reverberations from a global pandemic, fallout of geopolitical unrest, and a sustained period of inflation. Additionally, an evolving corporate governance environment has elevated the risk and scrutiny that directors are exposed to. All of this is set against the backdrop of declining share prices, with some sectors down as much as 30 percent year-over-year. As nearly 80 percent of all firms pay most of their director compensation in the form of equity, companies have been challenged to maintain compensation packages that are sufficient to effectively recruit and retain qualified board talent.

While equity awards to board members often represent a small portion of a company's burn rate, it is important to be aware and anticipate the effect depressed share values can have on director compensation. For companies that utilize a fixed-share approach (i.e., a specific number of shares granted each year), the year-over-year dollar value is likely to drop significantly. This presents a potential challenge in recruiting and retaining directors, as newly appointed directors will not receive the benefit of previous grants at a higher price, while tenured directors will receive less value than they have grown accustomed to.

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For companies using a fixed-value approach (i.e., a specific value granted each year) the number of shares needed to maintain a consistent year-over-year dollar value could increase significantly, creating potential optic and share-pool issues. Companies facing this dilemma may opt to rely more heavily on cash (in the near term), provide grants based on an expected future stock price, or grant a similar number of shares as in the prior years when the stock price was more aligned with its historic trading price. Companies relying on stock options rather than full-value shares are likely underwater on option awards granted in 2021 and 2022. Due to cash flow constraints, smaller companies generally provide cash retainers that are much more conservative than larger-cap firms and rely more heavily on stock options hoping for the upside to pan out. Directors holding underwater options while also receiving comparatively low cash retainers may decide that the compensation does not justify the time commitment or risk of sitting on a public board.

As a result of volatile share values and with economic headwinds expected to continue into 2023, it may be time to revisit the way in which director equity grants are determined. There are several factors that companies should consider when addressing this issue, including these:

- Balancing the company's responsibility and need to attract, retain, and align directors with shareholder interests at a time when significant enterprise value has been lost;
- Understanding the potential future value of awards granted at the low stock price to protect against unusual or inappropriate windfalls when the stock price recovers to its prior levels; and
- Recognizing limitations in long-term incentive program design that could create problems in the future (e.g., exceeding maximum award limits, outpacing burn rate standards, depleting share reserves too quickly).

About the Author

Jacob Harden is a vice president at Pearl Meyer. He advises boards and management in all areas of executive compensation, including compensation benchmarking, short- and long-term incentive program design, equity utilization, severance, and change-in-control provisions.

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.