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Designing an Effective Bonus Plan for Early-Stage Biotech Companies

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Establishing a well-structured bonus plan is critical for incentivizing employees and executives and aligning their performance with organizational goals. In early-stage biotech companies, where success often hinges on research and development (R&D) milestones, a thoughtfully designed bonus plan can motivate teams and drive corporate achievement. While every biotech company, its ultimate goals, and its milestones to achieve them are unique, there are four fundamental elements of effective bonus plan design. Following this general framework will help your organization balance corporate and individual performance, set appropriate goals, and ensure flexibility in performance assessments.

1: Plan Architecture

The foundation of any bonus plan lies in its architecture, which typically balances corporate and individual performance components. For most organizations, executive-level bonuses are heavily weighted toward corporate performance, with the CEO's bonus often tied exclusively to corporate metrics. Conversely, non-executive employees may see a stronger emphasis on individual contributions.

Determining the weighting of these components across the organization is a philosophical decision that reflects the company's values and strategic priorities. For example, tying the majority of executive bonuses to corporate performance ensures leadership accountability for organizational success. For other employees, linking individually achievable goals to the company strategy ensures they can control their outcomes while still contributing to corporate performance. This step is crucial because it lays the groundwork for how the company fairly rewards its employees and drives desired behaviors.

***Recommendation**: Start by clearly defining your company's priorities and its corresponding compensation philosophy. Align bonus weighting with those principles while ensuring clarity and consistency across the organization.*

2: Performance Evaluation

In development-stage biotech companies, corporate performance is typically assessed using a scorecard approach. Two scorecard designs are common for executives.

- **Weighted Scorecards**: Corporate objectives are grouped into specific categories such as clinical, R&D, corporate finance and business development, and culture and talent. Each category has assigned weightings and corresponding goals.
- **Unweighted Scorecards**: Corporate objectives are itemized in a "laundry list" manner without specific weightings.

Individual performance, on the other hand, is typically assessed using the company's performance management system and is incorporated into bonus plan payouts via two approaches.

- **Additive Approach**: Individual performance is a standalone part of the plan with its own discrete weighting. Individual performance and corresponding payouts are independent of corporate performance. This approach has the effect of moderating the impact of corporate performance on eventual plan payouts.
- **Multiplicative Design**: Individual performance is not a standalone part of the plan, and instead modifies plan payouts prescribed by the corporate performance factor. This approach links the two core components on the plan more closely and has the effect of amplifying payouts in "good" years but also heightens the downward impact of poor corporate performance.

While the additive approach provides stability, the multiplicative design creates stronger alignment between payouts and overall company performance. The choice depends on how closely leadership wants to tie individual rewards to corporate success.

Recommendation*: Evaluate your company's risk tolerance and performance volatility. Choose the method that best aligns with your goals and human capital objectives, including the impact on motivation and retention.*

3: Defining Goal Types

We encourage management teams and compensation committees to think about goals through the lens of "inputs" and "outputs."

- **Input Goals**: Execution-based objectives, such as completing clinical trials or meeting operational milestones. These are often preferred by management due to their controllability and motivational impact, and tend to dominate in early-stage biotechs.
- **Output Goals**: Result-based objectives, such as achieving clinical trial endpoints or securing regulatory approval. These align more closely with shareholder expectations but often involve factors outside management's control. These are often preferred by investors.

Considering goals in this way can be helpful when evaluating performance at year-end. In early-stage biotechs, there can be tension between paying for high levels of execution—over which management has more control—and paying directly for results—over which management has less control. For instance, management can run the best trial in the world, but they lack the ability to directly control the scientific outcomes. Thus, ensuring that the plan has a heavy link to output goals helps guard against a disconnect between pay and the shareholder experience.

Recommendation*: Design a balanced set of goals that reflects the realities of your business. Use input goals for routine milestones and output goals for stretch achievements that signify exceptional performance. Consider a funding cap or other gateway mechanism to emphasize the importance of output goals and results-based payments. At the outset of the plan, define what "superior" and "poor" performance might look like as a framework to assist in the performance assessment at year-end.*

4. Performance Leverage

Performance leverage refers to the thresholds and maximum payout opportunities that recognize varying levels of achievement. Most early-stage biotech companies set these opportunities between 70% and 130% of target payouts, with mechanisms to account for under- or over-performance. There are three common approaches.

- **Goals with Under/Overachievement**: Each corporate objective is assigned threshold, target, and maximum values. This approach works well for quantifiable objectives like financial targets.
- **Goals Sum to >100%**: Corporate performance categories are weighted such that achieving all goals results in payouts exceeding 100% (e.g., 125%).
- **Discretionary Adjustments**: Committees make holistic evaluations at year-end, adjusting payouts based on overall performance. This method offers flexibility but is open to subjectivity.

Performance leverage ensures that the bonus plan recognizes varying levels of success while maintaining flexibility to adjust for unexpected circumstances.

Recommendation*: Use a mix of quantitative and discretionary methods to create a performance leverage system that rewards exceptional achievements while maintaining fairness.*

Conclusion

Designing a bonus plan for early-stage biotech companies requires a careful balance between motivating employees, aligning rewards with corporate goals, and managing risks. By following these steps—defining the plan architecture, determining an approach to performance measurement, setting meaningful goals, and building a robust performance leverage system—organizations can create a bonus plan that drives both individual and corporate success.

Ultimately, the effectiveness of a bonus plan depends on how well it reflects the company's values and strategic priorities. A well-designed plan not only motivates employees but also aligns their efforts with long-term value creation, ensuring that both management and shareholders benefit from the company's success.

About the Author

Rob James is a managing director with Pearl Meyer with almost 15 years of experience in executive compensation and finance. He serves as a trusted advisor to boards and senior management at public and private firms across North America. He works with companies in all industries, but he has in-depth knowledge and expertise in designing compensations strategies for organizations in life sciences and technology, particularly emerging and high growth companies that are pursuing or have recently completed a M&A transaction or public offering.

About Pearl Meyer

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