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The Impact of Oil and Gas M&A on In-Flight Short-Term Incentives

Oil and gas industry merger and acquisition (M&A) activity has slowed over the last year as heavy consolidation reduced the number of opportunities. In 2024, oil and gas (O&G) companies concentrated on portfolio consolidation and cost optimization amid ongoing industrial challenges, such as restructurings and closures in petrochemicals. Other factors such as volatile commodity prices, energy transition pressures, and stricter capital discipline have also contributed to the decrease.

Despite this backdrop and the overall uncertainties driven by current trade policies, M&A actions may still be on the horizon for some O&G organizations, and they can be disruptive from a compensation standpoint. Few elements are as sensitive during these transitions as in-flight annual incentive plans. These plans are not merely compensation tools, they are also critical levers for retaining key talent, maintaining morale, and aligning executives with the merged entity's vision for creating value. Mishandling these incentives can destabilize even the most strategically sound merger.

The High Stakes of In-Flight Incentives

In-flight incentives encompass goals that have been set but are otherwise being interrupted by the M&A activity before the performance period has completed. These short-term plans often represent significant financial and emotional stakes for executives, posing both risks and opportunities for the acquiring company. Risks may include perceived windfalls, stakeholder scrutiny, reputational impact, dilution of accountability, and morale, while opportunities may include fostering accountability, building trust with stakeholders, and demonstrating the positive impact of the acquisition.

Instead of recalculating current incentive goals to include the acquired company's EBITDA, revenue, etc., and then restating goals for the resulting merged entity, there are advantages that can be gained by the acquiring company when the original goals of the in-flight annual incentive plan are retained. The acquiring O&G company in an M&A transaction is more likely to retain their original goals when the transition is later in the performance period or when the transaction is projected to have limited impact on

financials.

Below are several distinct benefits and associated scenarios where the acquiring company maintained their original in-flight annual incentive plan goals with positive outcomes.

Maintains Accountability

By keeping existing goals, the acquiring company holds its management team accountable for maintaining focus on current operations and delivering results despite the added complexity of M&A activity.

Situation: Company A completed a major acquisition during the final quarter of its performance period. Rather than adjusting its incentive plan goals to reflect the acquisition's impact, the company decided to hold its management team accountable for delivering results based on the original targets.

This decision reinforced the expectation that executives should remain focused on driving organic growth and operational efficiency, even amid the added complexity of integrating the acquired company. By not lowering or modifying goals, Company A emphasized that accountability for performance should not be diluted by external factors like M&A activity.

Outcome: Shareholders praised the leadership team's ability to stay focused and deliver strong results, reinforcing confidence in the company's ability to execute strategic initiatives.

Aligns with Shareholder Experience and Prevents Perceived Windfalls

Maintaining existing goals of the acquiring company ensures that incentive payouts align with the actual financial performance experienced by shareholders during the performance period, avoiding a disconnect between management rewards and shareholder value creation.

If the acquisition is expected to create long-term value, keeping the original goals demonstrates confidence in the deal's success and avoids signaling uncertainty to investors.

Situation: Company B made an acquisition late in its performance period that was expected to enhance long-term value but would have also made it easier for executives to meet revised short-term incentive targets if the goals were adjusted. Company B decided to keep the original goals intact. This approach avoided creating a disconnect between potentially outsized short-term management rewards unrelated to their individual efforts

and shareholder value creation.

Outcome: Despite the acquisition upheaval, Company B's leadership delivered results that aligned with shareholder return during that performance period. The resulting payout reinforced the principle that executives should be rewarded based on outcomes that directly impact investors, who viewed the decision to maintain original goals as a sign of transparency and fairness. This approach strengthened trust in the company's governance practices and avoided criticism from shareholders who might have viewed adjusted goals as self-serving.

Supports Strategic Consistency

Maintaining existing goals emphasizes the importance of the acquiring company executing the merger as part of the broader, long-term strategic plan, rather than treating it as an exceptional event that warrants special treatment.

Situation: Company C acquired a competitor during its performance period, marking a pivotal step in its long-term strategy to expand into new areas. Instead of treating the acquisition as an exceptional event that warranted special treatment, the company kept its original incentive plan goals unchanged.

This decision underscored the importance of executing the merger as part of the broader, long-term strategic plan. By not restating goals, Company C signaled to stakeholders that the acquisition was a deliberate move to drive sustained growth rather than a one-off transaction requiring adjustments.

Outcome: The acquisition contributed positively to Company C's overall performance, and executives achieved their original goals despite the added complexity. Shareholders viewed the decision as evidence of strategic discipline and consistency, bolstering confidence in the company's leadership.

Minimizes Scrutiny from Shareholders and Proxy Advisors

Adjusting goals post-merger can attract scrutiny from shareholders and proxy advisory firms (e.g., ISS, Glass Lewis), who may, like investors, view such changes as self-serving or lacking transparency. Maintaining the acquiring company's original goals reduces governance controversy and avoids potential backlash, while signaling that the company is committed to maintaining fairness and rigor in its incentive programs, even during periods of significant change.

Situation: Company D completed a high-profile acquisition late in its performance period, prompting discussions about whether to adjust incentive plan goals. Concerned about potential scrutiny from proxy advisory firms like ISS and Glass Lewis, the company decided to maintain the original goals, minimizing the risk of backlash from shareholders and

governance watchdogs, and avoiding perceptions of self-serving behavior.

Outcome: Company D's leadership met the original goals, demonstrating resilience and adaptability during a period of significant change and proxy advisors and institutional investors commended the decision.

Leverages Positive Acquisition Impact

Achieving or exceeding original, acquiring company goals during a transition can demonstrate to all stakeholders the positive impact of the transaction and reinforce the perception of a sound and successful decision.

Situation: Company E acquired an industry peer during the second half of its performance period. Rather than adjusting goals to reflect the acquisition's financial contribution, Company E kept the original targets to showcase the positive impact of the transaction on its core business.

By achieving or exceeding their original goals, Company E demonstrated that the transaction had enhanced operational performance and strengthened the company's competitive position in the acquisition year. This outcome reinforced the perception that the deal was strategically sound and value-accretive.

Outcome: Company E's leadership team delivered results that surpassed expectations, validating the acquisition as a successful strategic move. Shareholders and analysts praised the company's ability to leverage the acquisition's benefits while staying focused on its pre-existing objectives.

Simplicity and Administrative Efficiency

Finally, restating incentive plan goals requires recalculating targets, which can be administratively burdensome, especially if M&A activity occurs late in the performance period or involves multiple transactions. Keeping the acquiring company's original goals in place avoids the need to re-benchmark performance metrics, ensuring continuity in the incentive program without introducing confusion or delays.

Situation: Company F (the acquiring company) chose to maintain its original goals allowing the management team to focus on integrating the acquired business without being distracted by shifting goalposts.

Outcome: The simplicity of maintaining original goals ensured that the incentive program remained straightforward and transparent. Executives appreciated the clarity, and shareholders viewed the decision as a sign of disciplined governance.

While there are clear advantages to not restating annual incentive plan goals, companies should carefully weigh the pros and cons of their specific situation. Regardless of how a company proceeds with in-flight annual incentives, a clear communication strategy rooted in transparency is essential to justify the rationale and maintain trust in the incentive

program.

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.