

ARTICLE | SEP 2020

Biotech Companies: Don't Skip the Compensation Philosophy Step



Robert James

MANAGING DIRECTOR



Terry Newth

MANAGING DIRECTOR

A well-defined compensation philosophy is a key input for effective pay design. Not only does it serve as a basis for almost all compensation decisions, it is also a valuable tool for communicating—both internally and externally—a company's values and goals and how they translate into employee rewards. And despite their significance, compensation philosophies are an often overlooked component of compensation planning or they may only be quick, check-the-box exercises.

This is particularly true in the biotechnology industry, where it is arguably one of the more foundational aspects of compensation to get right. Given this industry's mission-driven cultures, intense competition for scarce labor, and very broad range of business strategies, a compensation philosophy is a key element for the organization's overall talent management strategy.

It is true that like mission statements, philosophy statements are somewhat abstract and developing one forces companies to consider complex questions to which there may not be clear answers. This is never an easy task but it can be particularly challenging for companies operating in high-pressure and fast-paced environments where there is real business risk and many other priorities to focus on.

Breaking Down the Compensation Philosophy

In its simplest form, a compensation philosophy is a summary of an organization's guiding principles for its compensation program. If it is relevant and done well, it will be informed by a thorough and ongoing assessment of organizational culture, strategy, and human capital needs.

While structures of compensation philosophy vary across companies and industries, they generally address the following key goals:

1. Documents objectives for the compensation philosophy
2. Defines appropriate competitive reference points
3. Describes the roles of various elements of compensation
4. Determines the relative emphasis of compensation elements
5. Clarifies the relationship between people, pay programs, and company purpose/values
6. Outlines company-specific pay considerations

Trends and best practices certainly create overlap in compensation philosophies across all

industries, although it's the subtle differences between companies within industries that can create competitive advantage. Taking time to carefully consider each of the items above is critical in the development process and, once defined, each item should translate and manifest itself in the overall compensation design.

Leveraging this Framework to Develop or Diagnose your Compensation Philosophy

Below, we present each component of a compensation philosophy and suggest key questions for companies to consider as they develop their policies. The resulting compensation philosophy outcomes illustrate how responses can translate into actionable items to drive compensation design.

Goal	Questions to Consider	Compensation Philosophy Outcomes
Documents objectives for compensation philosophy	<ul style="list-style-type: none"> • What is the ultimate purpose of the compensation program? • What key objectives do we want our compensation programs to achieve? • How are we using compensation to support our mission and strategic objectives? 	<ul style="list-style-type: none"> • Objectives that are centered around attraction, retention, motivation, and shareholder alignment • Additional objectives that serve to bolster culture (e.g., teamwork, mission, purpose, stakeholder alignment, etc.)
Defines appropriate competitive reference points	<ul style="list-style-type: none"> • To whom do we compare ourselves within the marketplace? • Which business and talent criteria are most relevant for developing comparables? • Does it differ based on level or function? • Where should pay levels be set in relation to the competitive market? • How should the pay positioning of elements of total compensation be differentiated? 	<ul style="list-style-type: none"> • A peer group of comparator companies, selected based on industry, size, business, and mission similarities • An articulated strategy around benchmarking approach at all levels that takes into consideration relevant labor markets • Compensation reference points that serve as a guide in developing pay structures and guidelines
Describes the roles of various elements of compensation	<ul style="list-style-type: none"> • What role does each element of pay play in achieving our stated objectives? • What different behaviors do our short- and long-term programs incentivize? 	<ul style="list-style-type: none"> • An articulation of the purpose of each element of pay and how each element aligns with stated objectives • Communicates the purpose of each component of the pay program
Determines the relative emphasis of compensation elements	<ul style="list-style-type: none"> • What is the relative emphasis of each element of pay (e.g., base salary, incentive pay)? • What is the relative emphasis of each type of compensation component (e.g., fixed versus variable, short-term vs. long-term incentives) 	<ul style="list-style-type: none"> • Stated position on the priority of compensation elements in terms of the portion of overall compensation that they represent • Communicates the priority of each compensation objective
Clarifies relationship between people, pay	<ul style="list-style-type: none"> • How does our compensation program tie to our 	<ul style="list-style-type: none"> • Ensures that the compensation philosophy and its underlying

programs, and company purpose/values	<p>purpose/mission?</p> <ul style="list-style-type: none"> • What are the critical competencies that we look for in employees? • Do these competencies support our key values (e.g., integrity, respect, etc.)? 	<p>objectives and statements tie back to the company's mission, purpose, and values</p> <ul style="list-style-type: none"> • Provides continual communication of the things that matter for the organization
Company-specific pay considerations	<ul style="list-style-type: none"> • What factors are unique to us which should be considered when making pay decisions? • What processes can we put in place that are consistent and defensible? • Under what circumstances should we update/reevaluate these processes? 	<ul style="list-style-type: none"> • Articulates how compensation decisions are made • Sets up when the process should be reviewed for appropriateness • Provides further opportunity to tie process and decisions back to culture, mission, purpose, and key objectives

Ongoing Assessment

Once the compensation philosophy has been developed and its principles are reflected in the pay program design, it's important for companies to conduct ongoing annual reviews to ensure that it remains relevant and that it's resulting in the desired outcomes. Below are a few examples of key compensation program objectives, and potential analyses that can be used to demonstrate whether the company is achieving its desired goals. There are also various tools that can assist in the monitoring process and diagnose potential issues.

Key Objective	Potential Analyses
Attraction of key talent that can help drive our mission and purpose	<ul style="list-style-type: none"> • Review of compensation ranges to ensure competitiveness • Review of compensation design to evaluate competitiveness and isolate differentiated design used in recruiting • Human capital metrics (e.g., top candidate acceptance rate, etc.)
Retention of proven talent	<ul style="list-style-type: none"> • Review of individual compensation arrangements to understand competitiveness • Review of the profile of current equity grants (unvested equity value, leverage, vesting events)
Pay for performance	<ul style="list-style-type: none"> • Metric correlation analysis • Pay-for-performance analysis • Operating plan execution analysis
Alignment of employee and shareholder interests	<ul style="list-style-type: none"> • Equity wealth sensitivity analyses • Share ownership guideline review

Of course, not every aspect of the compensation philosophy requires a specific quantitative analysis to confirm its effectiveness. In some instances, where there are inconsistencies between company culture and strategy, the lack of alignment between compensation philosophy and pay program design may be very apparent. (For example, if your strategy is to pay consistently below median, but you have retention problems.)

Most important, however, is that companies routinely revisit the philosophy and that this process allows decision makers among the board and in the executive ranks to optimize pay programs accordingly.

In Summary

While they can be difficult to define, compensation philosophies provide a consistent framework for companies to work within by ensuring that all pay decisions are drawn from the same set of values. The wave of energy around broadening of a company's purpose from creating value for shareholders to benefiting all stakeholders only serves to increase the importance of reviewing your existing philosophy to ensure it reflects your company and its purpose. It is up to compensation committees and executive leadership to ensure the compensation philosophy reflects company culture and evolves with it over time.

About the Authors

Rob is a managing director with Pearl Meyer with over 12 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 specializes in working with emerging and high growth companies that are pursuing or have recently completed a transaction, such as an IPO or deSPAC. He often works with clients to help them prepare for an IPO and in the design of equity programs across each stage in their lifecycle, including pre-and-post IPO. Rob works with companies in all industries, but he has in-depth knowledge and expertise in designing compensations strategies for organizations in technology, fintech, green tech, and life science/biotech.

Terry Newth is a managing director at Pearl Meyer. He consults on the design, development, and assessment of executive compensation programs that support each organization's business objectives, long term business strategy, and organizational culture. His clients range from Fortune 500 organizations to pre-IPOs to private and family-owned companies in a wide range of industries. Terry's areas of expertise include pay strategy and philosophy development, market-based pay studies, incentive plan design, severance and CIC arrangements, outside director pay, transaction-related compensation, CD&A and supporting table disclosures, corporate governance, and share plan authorizations.

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.