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Biotech Compensation Trends: Common Questions for 2024

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It is always our advice to construct executive compensation plans that take into account all of the unique attributes and circumstances of any given company. However, understanding the broad market context is important. The biotechnology space has some interesting dynamics that are more on the challenging side of late. My colleague Libbie Engels and I have recently received similar inquiries from a number of clients as 2023 came to a close and planning for 2024 ramped up in earnest. Here are the most common questions and what our life sciences practice are seeing as trends.

Q: How did other biotech companies approach salary increase budgets and actions for 2024?

Terry: The process of setting 2024 budgets has reflected tension between the need to reduce expenses and the need to retain talent, which is critical to meeting key strategic priorities that will unlock shareholder value.

Because of this tension, we saw a limited pullback on salary increase budgets relative to last year. For most, the merit increase pools tended to be in the 3.5% to 4% range, down from 4% to 5% in 2023. Additionally, many companies also budgeted for market adjustments and promotions with an incremental 0.5% to 1% salary budget, which was down from 1% to 2% in 2023. Where we saw deviation from these ranges tended to be geographically outside of the major biotechnology hubs, where the labor supply and demand situation is different, and among companies that were severely cash constrained and could not afford to provide competitive salary adjustments.

Q: What do bonus funding levels look like for FY23 relative to FY22 and are there any creative approaches companies are taking this year?

Terry: Some of the same principles we saw with salary increases is also in play for annual year-end bonuses. First and foremost, companies should be scoring the year based on performance against the stated objectives to arrive at a raw corporate bonus score—this principle shouldn't change year to year. The compensation committee and board typically review that scoring to ensure agreement, and assess whether the score is reflective of the year as a whole.

Last year's bonus cycle resulted in funding levels of 85% to 100% of target for most companies, particularly pre-commercial organizations. We expect to see similar results this year, albeit slightly reduced at the bottom end of the range with most companies landing between 75% to 100% of the target bonus. This reduced funding is likely a result of the challenges we saw in 2023 in terms of capital raising, pipeline progress, and operational setbacks.

We have observed two alternative models to funding bonuses this year which benefit non-executive participants. First is to have a higher corporate score for non-executives *if* the accountability for missed goals is primarily at the executive management levels (for example, failure to raise capital). In this instance you might see non-executives with 5% to 15% higher funding than the executive management participants. The second approach is to fund a higher level of bonus for the individual performance component, which many companies have as part of their design. This allows the company to better recognize high performing employees.

Q: How are companies sizing equity grants this year?

Terry: For year-end 2022, we saw a shift in the approach many companies used to size equity grants, moving from a value-based approach to an opportunity-based approach. For many, this was a necessary move as they could not deliver competitive long-term incentive values relative to their available share pool given the depressed share prices. We expect to see this approach continue for 2023 year end decisions.

Sizing equity awards as a percent of common shares outstanding is a much more reliable and stable method, specifically for biotech companies with market capitalizations falling below $1B. The strong correlation between stock price and equity compensation values results in high variability for benchmarking, especially in such a volatile industry. As a rule of thumb, with every $1M increase in market capitalization, CEO equity values increase by about $6,000. Theoretically, if the benchmark is off by $100M in market capitalization, the company's benchmark equity grant would be off by $600,000.

Q: Has the mix of long-term incentives changed at all?

Terry: Given retention concerns in an environment with significantly underwater options, there continues to be a shift to full-value shares (RSUs). About 15% of biotechs added RSUs last year, continuing a trend that we have seen for many years. As companies make a shift in their equity mix, we generally expect options to be supplemented with RSUs until the mix becomes 50% options and 50% RSUs, at which point companies begin to introduce PSUs. This maintains the appropriate balance between retention value (RSUs) and holding executives accountable for performance (options and PSUs).

Q: What are companies doing to address severely depressed stock prices?

Terry: Many companies have experienced sustained levels of depressed stock prices since 2021. As such, we have seen an uptick in equity retention awards, and to a lesser extent repricings and exchanges of underwater options. Retention awards may be appropriate if the share pool is sufficiently sized and the magnitude of underwater options is not significant. Companies in a more challenging situation with share availability and significantly underwater options may explore a stock option repricing or exchange.

When considering an option repricing or exchange program, key decisions are required to help inform the type of program to be implemented along with the associated required disclosures and/or shareholder approvals. Specifically, identifying what is allowed under the equity plan without shareholder approval, determining whether or not executives and board members will be included, incorporating features such as value neutral ratios, and setting a "floor" for eligible options are all important items to consider.

About the Author

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.

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