

Coronavirus and Compensation

What should companies do now?

BY JOHN BORNEMAN, BLAIR JONES AND KATHRYN NEEL

The sudden acceleration of the COVID-19 pandemic, with substantial economic damage to many industries, has companies scrambling to respond. The priorities, obviously, are to protect employees' health, first and foremost, and to manage the risk to the business. But after taking those steps, some companies will ask, "How do we appropriately motivate and reward employees now?"

For companies near the beginning of their fiscal year, their incentive goals have likely become impossible to reach already. Performance-based equity grants may be hopelessly

unearnable. As for companies preparing to set goals for the upcoming fiscal year, they face enormous uncertainty, making it difficult to work with the regular incentive plan cycles. How should companies respond to this unprecedented situation?

There are considerations for companies and boards to consider moving forward.

Principles

As a starting point, companies should establish clear guidelines for changes to incentive plans in light of the pandemic. These should include:

- If you have already made grants and set your

plans for the year, do nothing right now, other than agree that you will look at this issue over the coming weeks and months. Make sure to communicate this intent to your employees. Today there simply is not enough information on the depth and length of the economic impact for your company, so any decisions made now would likely need to be unwound.

- Expect liberal use of judgment and adjustments at year-end or a "reset" for the year, but likely not one that protects current incentives completely. This is a difficult environment where shareholders are losing money and em-

ployees are losing jobs, so compensation cannot be business-as-usual. Most companies in most industries should plan for lower than normal outcomes for the year, including the possibility of no incentive pay.

- Balance compensation decisions for executives with the experiences of the broader employee population. Executives may need to lead by example, taking reduced pay across multiple dimensions to help mitigate the impact on employees least able to weather the storm, and share in the pain felt by the organizations they lead.

- Maintain strong governance. For senior leaders in particular, shareholders will want a meaningful relationship between pay and performance. Use caution before leaning in on retention, and be careful about windfalls for limited populations if there is a stronger than expected recovery. Shareholder engagement will matter more than ever.

any incentive plan payouts. The company may need to focus on substantial cuts instead. Many hotels and airlines, and some companies in other industries, have already greatly reduced executive salaries, forfeited or reduced bonuses for the prior year, and reduced board pay as well. More will follow suit if the economy tips into a full-blown recession.

completed; non-financial objectives may also be of limited value as companies are focused on crisis response.

- Long-term incentive plans have lost significant value. Performance-based shares tied to financial results, like annual incentive plans, may be unattainable, especially for cycles ending in the near term. Performance share unit

not already approved incentive plans for the year, the key issues are quite different:

- Goal-setting for either annual or long-term incentive plan cycles will be extremely difficult given the high degree of uncertainty.

- Significant reductions in share prices could dramatically increase the dilution from equity incentives if target grant levels are maintained without adjustment.

- At the same time, delays in establishing the incentive plans or making awards will add to the uncertainty for plan participants.

These are only initial considerations in a fast-moving environment and will need to be judged with careful consideration of employee and shareholder experiences. We therefore urge caution when making any commitments in the near term and before taking any action. We also urge you to acknowledge to employees that the company's plans and programs for the year have been up-ended and will likely need to be reconsidered as the future becomes clearer. ■

John Borneman, Blair Jones and Kathryn Neel are managing directors at Semler Brossy.

Companies may worry about executive turnover as a result of rapidly falling share prices and declining pay. But it seems premature to focus on this issue when every industry is being affected. Most employees will be eager for stability rather than change.

- Get ahead of your shareholder communication. Continually track the pandemic's effects on your business so that you base your compensation decisions on facts. Shareholders will need justification for any adjustments for the senior leaders. Make your decisions with a clear rationale in mind.

- Assess your worst-case scenario. For some companies, the crisis may be an existential threat to their business or industry. Where this risk is high, boards and senior leaders will need to be extra cautious about

Tactical Details

Many companies are likely to want to adjust their compensation to reflect the new environment. The issues involved will vary by company but depend most on whether their incentive plans for the current fiscal year have already been approved. For e companies that have already approved incentive plans for the current year, the key issues include:

- Financial objectives for the annual incentive plans will likely be unattainable already, even with only a quarter of the year

cycles ending in 2021 and 2022 should be carefully assessed, as there is a longer runway for success. Options are likely underwater, and restricted stock units are worth a fraction of their value at grant.

Companies may worry about executive turnover as a result of rapidly falling share prices and declining pay. But it seems premature to focus on this issue when every industry is being affected. Most employees will be eager for stability rather than change.

For companies that have