BRINGING PURPOSE INTO PAY PROGRAMS

Examining non-financial metrics in the wake of the Covid-19 crisis.

ALREADY A FOCUS IN boardrooms, ESG practices are coming under greater scrutiny as unprecedented challenges brought on by the global pandemic continue to unfold. *CBM* spoke with Kathryn Neel, managing director at Semler Brossy, about how boards should be rethinking their approach to executive pay and incentives in its wake. Excerpts follow.

The Covid-19 crisis is putting the issue of corporate purpose to the test. How should companies be looking at purpose-related goals in executive pay and incentives plans today?

It's absolutely true that purpose is as front and center as ever. There's risk, maybe more so now than ever, for any organization unable to develop a strong connection for employees, the communities it serves and customers to their company's purpose. Once they've been alienated, it may be difficult to win them back.

At the moment, a lot of companies are acutely focused on survival and recovery. Part of the survival strategy will involve difficult decisions that negatively impact employees and suppliers, if not some customers as well. Managing tradeoffs has always been part of an executive team's role, but as they're forced into more of these types of decisions than usual, these tradeoffs might find their way into incentive plans.

Shifts in financial objectives include things like managing or cutting costs in a fair, balanced way; maintaining investment in critical R&D; and protecting the solvency of the business. These may all become higher priorities than typical measurements of sales and profits.

Incorporating purpose-related goals into executive pay and incentives may also mean giving greater prominence to some non-financial objectives and letting purpose lead the way. This could mean, for example, a greater focus on the quality of the products a company produces, the perceived level of customer service it provides or, perhaps, the measured impact its operations have on the environment.

Although the dialogue to increase the prominence of these objectives began long before this pandemic, there may be more "room," if you will, to focus on this now.

What kind of human capital-related goals should boards be considering for their management teams?

There's no doubt that many boards and leadership teams are extremely worried about the retention of their top talent or filling roles in the organization when business returns to normal. Some companies may see low buyout values of outstanding long-term incentive awards for executives as an opportunity to upgrade their talent.

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Employees who are not completely satisfied with their employer's value proposition now have very little at stake if they find a better opportunity.

Compensation might not be an option, or the most effective or efficient option, for some companies to shore up their top talent right now. They will need to look to other ways of supplementing the hard retention value they have to offer through pay by, for example, focusing on employee engagement and diversity and inclusion, or placing more emphasis on leadership team results in succession planning and leadership development.

In implementing non-financial metrics in pay programs, what disclosure considerations need to be considered?

There's no doubt these are unprecedented times and there will be a need for exceptions to the conventional compensation norms. For any company considering a departure from "normal pay practices," transparent disclosure will be extremely important. Companies considering an action that could test boundaries might consider engaging first with key stakeholders before any decisions are made.

Disclosure should make clear: One, which were the primary objectives that came out above other factors considered. Two, which alternatives were considered and why were they not pursued. Three, what process was followed for making the decisions. And four, how the decisions benefit stakeholders.

As directors head into their next comp committee meeting on non-financial or ESG-related metrics, what's the number one thing to keep in mind?

Start with business priorities because they're evolving, I'm sure, as we speak. Before, some non-financial measures may have felt like a means to an end of financial results, but now focus and attention is on key priorities that will help the business in the near and long term, whether that be related to developing and retaining key talent, funding operations for a period of time or measuring the impact the business has on its communities and environment. That may go a long way in helping the company get through these trying times.

Kathryn Neel, managing director at Semler Brossy, advises board compensation committees and senior management teams on executive and non-employee director pay.

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