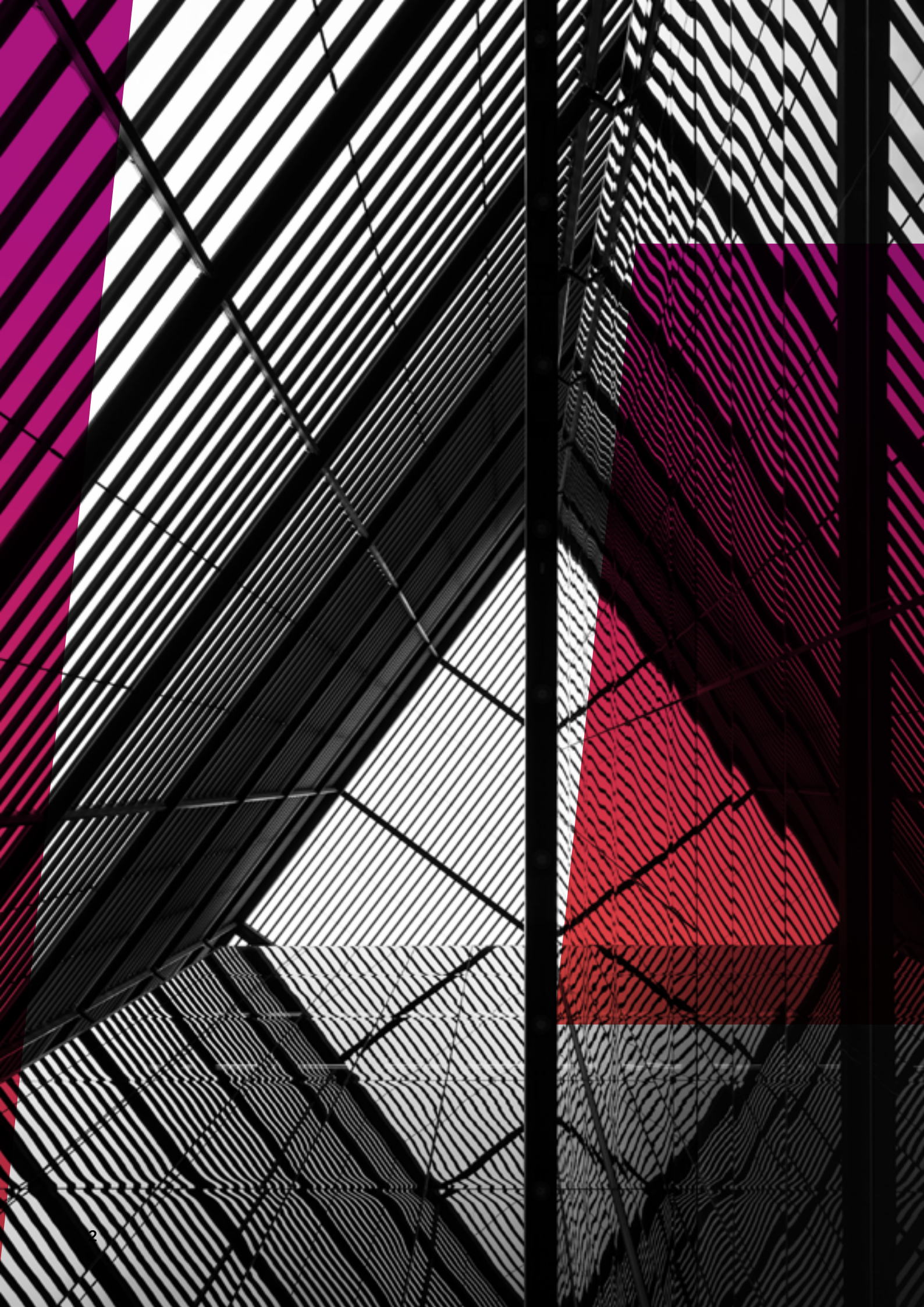




KORN FERRY'S PERSPECTIVE ON
**EXECUTIVE PAY
ACTIONS ARISING
FROM COVID-19**

**A new Compensation
Committee game plan.**



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INTRODUCTION

Not since the Great Depression of the 1930s has the global economy been under so much pressure. While there are echoes of the financial collapse of 2008, the economic pain from the current pandemic is far wider and deeper. Fissures have formed in entire industry sectors and millions of employees have been terminated or furloughed. And yet the biggest casualties of this crisis are the tens of thousands of people who have lost their lives, and the hundreds of thousands more who have been hospitalized.

Given these unprecedented times, corporations around the world have acted in unprecedented ways. They have found ways to create new virtual work arrangements for large segments of their workforce. They have kept employee well-being at the top of their priority list. They have found new ways to stay connected to and interact with their customers.

But the crisis has also taken its toll on the workforce beyond the obvious impact of the health crisis. Companies have been forced to shut down large portions of their operations, if not close their doors altogether. And, as a result, millions of people have been subject to furloughs, job cuts, or hefty pay reductions. Amid this turmoil, executive compensation has naturally come under an even brighter spotlight than usual.

Many CEOs and senior executives in the companies hardest hit by the COVID-19 crisis have announced significant pay reductions of their own, and others will likely follow suit. Cutting pay for executives is a visible and potentially necessary step in stabilizing some companies as they manage through the crisis. It sends a positive message to both employees and shareholders, and could enhance, or at least limit the tarnishing of, the company's reputation. While some outside observers have heralded these early actions, others have opined that they are too few and too limited.

Regardless of one's perspective, make no mistake about it – new approaches must be adopted to deal with executive compensation in our radically altered world. Dusting off playbooks from earlier crises is a waste of time. We need a new game plan to make decisions and to adapt to new rules that are emerging every day (think about the CARES act recently passed by the US Congress).

Just as CEOs and other senior leaders must carefully weigh their decisions and approaches to implement pay cuts for the broad employee population, Compensation Committees must do the same with executive pay. Executive pay involves many more variables, and the approach and consequences (intended or otherwise) of possible changes must be carefully evaluated. While the actions taken by one company or a group of companies may garner favorable reactions, and it may be tempting to copy them, what is “best practice” now is what is best for your company, based on how COVID-19 has affected your business, your overall philosophy and strategy for managing the business, how you foresee eventual recovery, and how you are handling other aspects of cost management. There is no safe harbor in saying “we’re just following market practice”.

In this brief guide, we share Korn Ferry’s perspective and point of view on many of the key questions that Compensation Committees are asking about possible adjustments to executive compensation. At the outset, we recommend four leadership behaviors and guideposts to determine the best course of action. We set these out on page 5.





Leadership guideposts for Compensation Committees navigating the crisis.



BE CALM

There may be pressure for quick action. But the business impact of COVID-19 and the outlook and prospects for a recovery are evolving daily. Stay strategic and above the frantic pace. Try to tune out wild speculation about a protracted depression or a snapback recovery, and deal with available facts. Don't make a rush to judgment.



BE FAIR

Historically, executive pay actions have been disconnected from those for the broader workforce, both in quantum and decision rules. During this crisis, many companies have sought to “flip the equation”; to demonstrate that personal economic pain will be shared, and that CEOs and senior executives will be subject to the first and most significant reductions in pay.



BE DECISIVE

When the time comes for a decision, make it and move on. Companies don't have the luxury of discussing change over multiple quarters. The magnitude of the financial impact on their business doesn't allow it. That said, sometimes the best decision after studying the situation is to decide to act later.



BE GUIDED BY PRINCIPLES

Beyond fairness, companies that have adopted and abide by well-defined compensation strategies and that use systematic approaches to handling crises, exceptions, or discretionary decisions, are the ones that will generally make the best decisions in the long-term interests of the company and its many constituents and stakeholders.

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At the outset, we recommend four key leadership behaviors and guideposts to determine the best course of action.

FORMULATING A GAME PLAN

If your company is already in deep financial stress, you have likely already made significant decisions about some of the executive program elements. All other companies have likely begun to consider the decisions they will need to make in the near future.

We believe it makes sense to organize your planning in the context of when you are likely to have to take various actions. On the following pages we share a suggested approach for addressing possible executive pay issues.

Our suggested approach for addressing executive pay issues.

IMMEDIATE-TERM

01

The Compensation Committee should by now have a clear understanding of company goals for cost management and cash preservation. Management should estimate how much of any cost reduction should come from people costs, and how the people cost saving will be achieved (furloughs, staff cuts, salary freezes, salary cuts, etc.).

Depending on the anticipated timing, duration, and depth of the financial impact, and the associated people cost reductions, this may call for immediate adjustments to executive salaries. CEOs and other top executives should take the largest percentage reductions and for the longest duration, especially if job cuts are anticipated.



OUR POINT OF VIEW

Be bold in identifying executive salary actions and communicate them clearly and broadly, preferably ahead of any broader pay or staffing actions.

02

As you consider executive salary actions, simultaneously review the executive compensation philosophy and strategy for guidance about how to consider and prioritize executive pay actions. Focus especially on the decision-making principles. If they are not current or lack relevance, update them.



OUR POINT OF VIEW

Most executive pay philosophy statements are silent on the issue of “fairness”. Now is a good time to consider including a clause addressing how the Committee will assess and assure the fairness of various elements of the executive pay program and the decisions it will need to make each year and over time. How do we define fairness? Relative to what or who? How will this affect the way we approach decisions and how they are communicated?

IMMEDIATE-TERM

03

Prioritize the actions to take and determine the timing for taking them. Adjustments will first involve base salary and any executive perquisites. These are the easy and obvious places to start and will generate cash savings the quickest.

Next in line is the short-term or annual incentive program, where payments are usually and mostly denominated in cash, and then the long-term incentive and stock-based programs (which, by their nature, are measured over more than a year and should be the last area for change). And as any executive pay reductions are contemplated, the Compensation Committee should also assess adjustments to compensation for members of the Board.



OUR POINT OF VIEW

Companies should consider the following sequence in addressing possible executive pay changes:

1. Executive benefits, perquisite 401k contributions, SERPs, or ESPPs.
2. Cash retainers for members of the Board.
3. CEO/senior executive base salaries.
4. Annual incentive
5. Long-term incentive

NEAR-TERM

04

Determine if there is a need or perceived benefit to modifying the short-term incentive plan. Factors to consider are where the plan is in the performance cycle, how significantly the performance metrics are likely to be affected by the business downturn, what portion of target bonus is likely to be available to pay under various performance scenarios, and what the company's needs for cash are likely to be.

Depending on your answers to these questions there are a variety of possible outcomes. If business impact has so far been light, you may decide to wait a quarter before deciding to make any changes. Other companies may decide to adopt a "stub plan" only for the second half of the year when recovery is anticipated and develop metrics and goals and pro-rated awards accordingly. Those facing significant business disruption may scrap their original plans and either commit to determining partial awards on a discretionary basis at year end, or scrap bonuses for 2020 altogether.



OUR POINT OF VIEW

Companies deciding not to scrap their short-term incentive plan, should consider building a framework for determining awards on a discretionary basis using two levers. First, making adjustments to the full-year metrics and second, over-riding the formula-based payouts taking into account a holistic view of company performance.

05

Next up are possible modifications to the long-term incentive plan or equity grants that are mid-cycle.

Performance-based long-term incentives require the same examination as the short-term incentive plan in terms of the likely impact of the financial downturn on the achievement of financial objectives.

Here again, there are a range of possible outcomes, from doing nothing (especially if new performance cycles start each year and new grants are made), to modifying the target performance level for all outstanding performance cycles, to changing the objectives against which performance will be measured and awards calculated (including using performance relative to peers). These plans are long-term in nature, and the company's performance could bounce back significantly post-COVID-19 and during the remainder of the performance cycle.



OUR POINT OF VIEW

We believe, in general, that any existing performance cycles should proceed as is, with the Compensation Committee retaining discretion to determine awards at the end of the performance period. However, if performance metrics are no longer aligned with the current business priorities, consider truncating the current outstanding cycles, and create new "stub plans" for the remaining years of each outstanding grant.

NEAR-TERM

06

The final consideration is any equity or stock-based long-term incentives that have not yet been granted in 2020. Things get a little (or a lot) trickier here.

Some companies need to make decisions now with respect to sizing this year's grants, and it's more complicated now with severely reduced stock prices. There is an array of complex issues to consider, too many to cover in this brief paper (burn rates, type of equity program(s), extent of stock price decline, overall magnitude of "normal" equity grants, portion of total compensation normally delivered through equity grants, etc.).

The main driver of increases in executive pay during the long eleven-year bull market were equity-based long-term incentives. These programs are the most lucrative and, along with performance based LTIs, attract the greatest scrutiny of CEO and senior executive pay. A 50% reduction in a CEO's base pay will look like nothing if the company significantly increases the number of shares granted in the equity program to adjust for the drop in share value (potentially increasing award values by millions of dollars). We suggest instead granting the same number of shares as the prior year or using a stock price equal to an average of the price at the start of the calendar year and the price at the grant date to calculate the number of shares to grant.



OUR POINT OF VIEW

Adopt a carefully measured if not conservative approach in adjusting the size of equity grants due to stock price declines.

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This is a dynamic situation and requires continuous attention.



MEDIUM-TERM

07

The Compensation Committee should commit to monitoring developments during the year and revisiting decisions made to evaluate if they continue to make sense and the need for any mid-course corrections. This is a dynamic situation and requires continuous attention.



OUR POINT OF VIEW

Compensation Committees should plan to meet/connect more often than in a “typical” year (at least quarterly during the current crisis) to review a scan of market developments and test current plans and processes.

08

Consider adjusting or limiting outsized executive cash incentive awards resulting from spikes in revenue and profit generated by impact of COVID-19. Just as some companies will exercise positive discretion in adjusting awards for the negative impact of COVID-19, we believe those that are positively affected by the health crisis should consider negative discretion to dampen any unexpected windfalls from the positive impact on their business.



OUR POINT OF VIEW

Take a realistic view of how company financial results have been affected. Consider applying “governors” on possible spikes in incentive plan payouts that are generated principally by COVID-19-related spikes in demand and business activity.

09

Consider the likely reactions of institutional investors and those who advise them. Well informed and principled Compensation Committees, supported as needed by capable advisors, are in the best position to render decisions that are in the long-term best interests of the company and its shareholders.



OUR POINT OF VIEW

Be aware of their perspectives and likely reactions but exercise your own best judgment and trust it.





LONGER-TERM

10

Revisit and consider revamping your executive compensation program to fit a new reality. At the outset of this document, we commented that the game has changed, rules have been rewritten and the old playbooks are useless.

With that in mind, we have already reached a point that Compensation Committees are questioning the fundamental thinking that has guided decisions in the past and are contemplating not just reactionary program tweaks but more sweeping adjustments to the structure and mechanics of executive pay programs and associated governance practices.

Do we have the quantum right? Are we paying for the right results? Does our approach to pay align with attracting and rewarding leaders with the right attributes to lead in a new world? Are we encouraging responsible risk-taking? Is our executive pay fair?



OUR POINT OF VIEW

Be bold and willing to challenge conventional wisdom. What worked in the past is no longer a reliable guide to inform future decision-making.

Consider how your company will likely need to evolve to compete on a radically different business landscape. Assess the implications for the kinds of leaders you will need moving forward, and then determine the elements of the new rewards philosophy that aligns with the roles you will need them to play.

Don't wait to see what everyone else is doing. Don't wait for permission from institutional shareholders. Be a leader.



Be bold and willing to challenge conventional wisdom. What worked in the past is no longer a reliable guide to inform future decision-making.

CONCLUSION

We hope the guidance we have offered in this brief white paper will help guide your planning and deliberations. Korn Ferry believes strongly that adherence to a few key principles, coupled with thoughtful planning and deliberation, and access to relevant data and facts, will produce the best decisions and the right outcomes for each organization.



As a reminder, here are the four key leadership behaviors we believe are key to considering executive pay decisions during this crisis:



BE CALM



BE DECISIVE



BE FAIR



BE GUIDED BY PRINCIPLES.

We are with you all the way and welcome your call if you feel you could benefit from hearing more or by working with one of our Executive Pay and Governance experts.

Your questions answered.

To accompany this whitepaper, we have created a document that brings together the top ten questions we are hearing from clients about executive pay. It provides a helpful summary of our perspective to these questions and the key issues we all need to consider as we work through the complex array of issues generated by this crisis.



[Download your copy here.](#)



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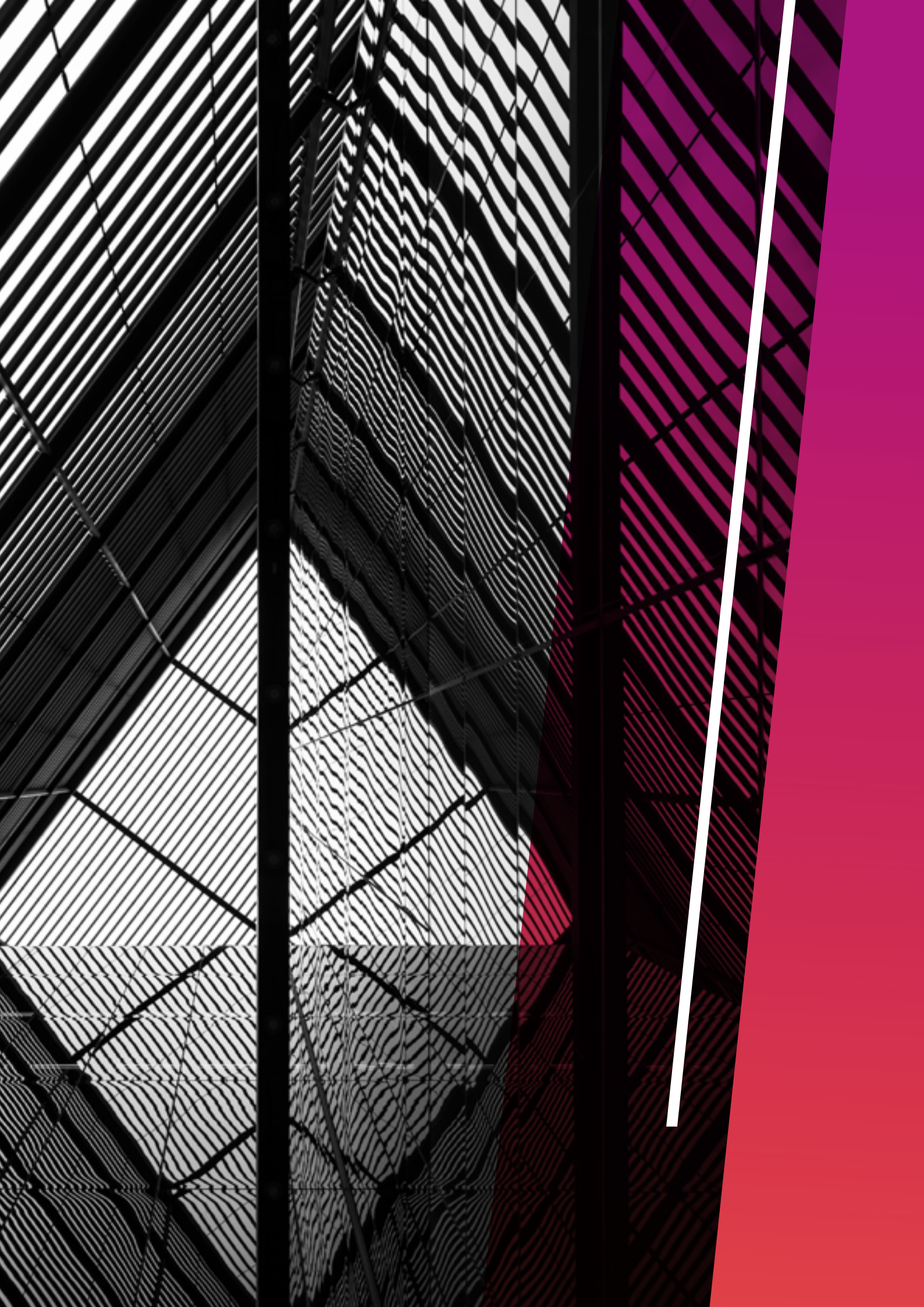
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About Korn Ferry

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