REEXAMINING HIRING PAY PRACTICES

As competition for talent intensifies, companies may need to rethink executive recruitment packages.

THE PAST 18 MONTHS brought changes to virtually every aspect of business—and hiring is no exception. Companies that grew comfortable with a remote work model during the pandemic are now able to draw from a wider pool of candidates. On the flip side, employees reticent about relocating suddenly find themselves far more marketable. At the same time, the pandemic-inspired hiatus on changing employers has faded as a sense of normalcy returns.

"It's always been a national or even global job market, but for many people, that traditional barrier of relocation friction is now gone," says Ken Sparling, managing director at FW Cook. "There's just a lot more mobility in the market."

Meanwhile, talent is scarce, particularly in technology, engineering and R&D roles. As a result, whether seeking a new CEO or hungry to hire high-performing talent with the skills and background required, companies should be prepared to provide competitive compensation packages.

> **"DUE TO SUBSTANTIAL WEALTH CREATION FROM THE MARKET'S REBOUND SINCE MARCH OF 2020... A LOT OF EXECUTIVE TALENT IS CURRENTLY SITTING ON SIGNIFICANT EQUITY VALUES."**
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> **—Ken Sparling, FW Cook**

FILLING THE BUCKETS

Generally, determining the appropriate ongoing pay for a given role is relatively straightforward, dictated by a market study and the company's existing pay philosophy, says Sparling. "When you're recruiting an experienced CEO or executive externally, the regular pay is typically positioned competitively against those of peer companies," he notes. "It's the two additional buckets—make-whole pay and inducement pay—that often require more careful consideration."

Make-whole pay, which typically consists of the amount of cash bonuses due to be paid that fiscal year and/or unvested equity, compensates a new hire for funds he or she will sacrifice by leaving the company early. Inducement pay consists of

Hiring Offer Do's and Don'ts

Offer Component	Do...	Don't...
Annual Compensation	▪ Align with the company's current executive pay philosophy and structure ▪ Provide for compensation committee discretion to adjust compensation year-to-year	▪ Exceed competitive norms in the ongoing package ▪ Lock in a pay mix that is less performance-based than executives at similar level ▪ Include multiyear guaranteed salary increases or bonuses
Make-Whole Award	▪ Replace like-for-like to extent possible, separating from regular annual compensation ▪ Provide vesting acceleration in a not-for-cause termination ▪ Include claw-back for a voluntary resignation	▪ Add the new hire into "in-flight" multiyear performance grants
Inducement Payment	▪ Link to performance, particularly for larger CEO hiring packages	▪ Provide for full vesting acceleration in termination scenarios (different from a Make-Whole Award)

additional compensation meant to offset the risk of leaving a stable position for a new opportunity—and taking on the risks that go along with it.

Despite the clear rationale behind each component, the amount of total compensation in such a package can trigger shareholder ire. And this year, current market conditions are exacerbating that outcome, notes Sparling. “Due to substantial wealth creation from the market’s rebound since March of 2020 and SPAC and IPO activity over the past 18 months, a lot of executive talent is currently sitting on significant equity values,” he explains. “That’s raised the cost of bringing in experienced, qualified talent. We’re seeing the knock-on effects of that now as companies that made high-profile hires disclose those values in their proxies.”

CEOs or executives with lengthy track records of success often warrant large make-whole grants due to having earned substantial equity value at their prior company. In such cases, boards should be prepared to handle pushback from investors. “Some shareholders have aversion to seeing CEO compensation values that are double market or above a certain threshold amount,” explains Sparling. “So, if a hiring award takes pay disclosure above $30 million, for example, many shareholders just won’t support it, even when the company has made the case that it was a one-time action to bring the person on board.”

COMMUNICATING COMP

Both the way that pay is structured and how compensation packages are disclosed can mitigate the risk of shareholder objections (See “Hiring Offer Do’s and Don’ts,” opposite). For example, boards may want to consider having a portion of make-whole and inducement awards vest over time. How each component of the pay package will be treated if the hire doesn’t work out should also be carefully weighed.

Companies should also avoid practices likely to trigger investor concern, such as multiyear salary increase guarantees or a severance package that exceeds two to three times salary and bonus.

It’s also critical to avoid a hiring package that will continue to be objectionable for multiple years running. “It’s important that on an ongoing basis the pay package is structured in such a way that it will not, by itself, continue to attract criticism,” says Sparling.

Finally, boards should be prepared to break down both the pay package’s provisions and the rationale behind it for investors. Proactively outlining the amount of regular pay versus one-time pay can offset knee-jerk reactions to the headline number.

“Make sure the different components of the hiring package are set forth clearly, especially when there’s a chance of attracting external criticism,” says Sparling, who says a proactive approach to outreach may calm shareholder concerns.

“Companies should put themselves in the best possible position to get say-on-pay support for the actual hiring package or for the vote the year after the hire is made,” he says. “Then, even if that vote is negative, you will have set the framework for a rebound in future years and be able to get support going forward.”

Ken Sparling, *managing director at FW Cook, consults with public and privately held companies on all aspects of executive and board compensation, including annual and long-term incentive programs, employment agreements and change-in-control arrangements.*