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ADVISOR BLOG

Observations on 2020 Annual Bonus Alternatives

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As the global and US economies slowly emerge from the initial shock of the COVID-19 crisis, the compensation committees of companies affected by the pandemic must now grapple with the possibility that many 2020 bonus plans are unlikely to pay out through no fault of management. While there are many possible variations on a theme, there are five basic approaches available to deal with this dilemma. To help select among them, below are observations on each.

Do Nothing – Let the Chips Fall Where They May

While likely the most appealing approach to proxy advisors and investors (particularly for companies whose stock price has been decimated), doing nothing runs the risk of short-changing a management team that may have gone out of its way to minimize the impact of the crisis. Doing nothing also could result in eventual retention issues. Remember, the external optics of rewarding management for their efforts during the COVID-19 pandemic likely will be viewed far more benignly than following the Great Recession of 2008-2010. Hence, assuming a company's ability to pay is coupled with good management performance under the circumstances, this is arguably not the best option.

Reset 2020 Goals

Resetting 2020 bonus goals to reflect the estimated impact of COVID-19 appears to make sense on the surface, particularly for calendar fiscal year-end companies whose original goals were established early in the first quarter. However, the uncertainty surrounding the potential economic rebound from COVID-19 and its associated timing may make establishing new goals problematic for many organizations. As a result, this solution appears realistic only for companies (which are probably few and far between) that have a relatively clear vision of their potential for the second half of the year.

Tie the 2020 Bonus to Achievement of Second-Half Goals

A variation to resetting 2020 goals is to ignore the first half of the year (i.e., January through June) and link bonuses solely to second-half goals or to strategic objectives related to reigniting the business. Similar to resetting 2020 goals, while appealing, this approach could be equally problematic for many companies due to continuing economic uncertainty.

Use Committee Discretion

Given the issues associated with establishing revised goals, many committees will be tempted to simply wait and apply year-end discretion to set 2020 bonuses. While a potentially attractive alternative due to the revised tax treatment of performance-based compensation, below are some caveats:

- Discuss the potential use of discretion and the basis for determining discretionary bonuses as a possible alternative and document this discussion in the committee minutes of a meeting prior to the actual use of discretion (ideally this summer for a calendar year company);
- At the same meeting establish a potential maximum discretionary bonus pool (e.g., somewhere between threshold and target) for accrual purposes; and
- If discretion is eventually used, clearly disclose the rationale behind the payments in the 2021 proxy.

Defer 2020 Bonus into 2021

Under this approach, all or part of the 2020 bonus opportunity would be deferred into 2021 based on goals established for the 2021 fiscal year. In other words, rather than making a plan modification to rationalize a bonus for 2020 performance, increase the 2021 bonus opportunity to give management a chance to earn all or a portion of the "lost" 2020 bonus. One appeal of this approach is that the external environment needed to set more realistic goals likely will exist. Another is that, unlike committee discretion, it maintains a direct tie-in between payout and performance versus preset, objective goals.

In the end, no approach fits all companies and situations. This said, there is something quite appealing about the pay-for-performance linkage inherent in deferring the 2020 bonus opportunity into 2021 in situations where establishing revised 2020 goals is problematic.

About the Author

Gary Hourihan is a managing director in the Los Angeles office with over 40 years of experience consulting to boards and senior management on compensation, leadership, and talent management issues. His experience spans a variety of industries and includes engagements for large, publicly traded firms, small- to mid-cap companies, and privately held organizations.

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