Pearl Meyer

ADVISOR BLOG

Why Our Current Crisis is Very Different from 2008

AUTHOR

Matt Turner
Managing Director

Gary Hourihan
Managing Director

The economic repercussions of the COVID-19 pandemic have many of us making comparisons to the Great Recession of 2008-2009, but there are some critical differences which impact how companies should approach potential compensation issues. First, the Great Recession was largely created by an overly aggressive (some would say out-of-control) banking system. Government actions to control the damage were both essential and extremely unpopular, resulting in legislative backlash (Dodd-Frank) and little sympathy for the Great Recession's impact on management pay. By contrast, our current economic crisis is the result of an act of nature.

Second, with few exceptions, the devastating impact of the Great Recession was felt across all business sectors, whereas the impact of the COVID-19 pandemic has discriminated between industries, with some sectors—such as grocery chains and pharmacies—actually benefitting while others—such as airlines, brick-and-mortar retailers, and dine-in restaurants—are bearing the brunt.

The third difference between the two crises is social context. Partly driven by the reform movement in the wake of the Great Recession, we now live in an era of heightened concern over environmental, social, and governance issues (ESG). That a global pandemic is the cause of our current economic crisis only reinforces this concern.

These differences imply two, perhaps seemingly contradictory, signals regarding potential compensation actions. First, any action should be tailored to your company's specific circumstances and be a direct function of the degree to which your firm is affected by COVID-19. Second, companies will face an unprecedented level of scrutiny regarding how their actions respond to ESG concerns and a community-wide sense of fairness.

As illustrated below, the economic impact varies greatly across industries. For those most negatively affected, we believe there will likely be much greater tolerance on the part of management and the board for compensation actions that address major reductions in cash incentives or the loss of equity/stock option value. But at the same time, those companies will be held to a higher standard of fairness and shared sacrifice. As an example, a company forced into plant closures might find a new tolerance for cancelation and replacement of equity incentives if executives earn no cash bonuses for the year and take meaningful salary cuts along with the broader workforce.

Economic Impact	Likely Examples	Potential Compensation Concerns	Potential Actions
• Windfall gains	• eCommerce • Work-at-home products/services • Medical supplies • Grocery chains	• Optics of large incentive payouts due to the crisis • ESG narrative; community actions	• Negative discretion • Additional funding of a firm foundation • Deferral of "excess" cash incentive awards
• Little to no change; mix of positive and negatives	• P&C Insurance • Fast Food • Agriculture • Trucking	• Fairness of outcomes within the firm • Overreaction	• None • Mixed discretion within the firm
• Moderate losses; negative growth	• Banking • Consumer goods • Industrials • Construction • Real estate	• Salary costs • Effectiveness of incentives • Overreaction	• Salary cuts or freezes • Salary deferrals into equity • Recalibration of annual incentive goals • Use of positive discretion
• Major losses • Liquidity concerns • Layoffs and closures	• Oil & gas • Airlines/Travel • Hospitality	• Survival	• Salary cuts • No annual incentives or swaps for equity • Recalibrate LTI goals

Actions taken by companies that are significantly impacted by the virus can logically be more proactive and aggressive, and likely will result in little backlash so long as care is taken that sacrifice is shared. This said, large discretionary bonuses or stock options granted at current depressed prices are likely not the answer, even if justified by outstanding individual effort and performance. Rather, more defensible actions later on might include increasing 2021 annual and long-term incentive opportunity to replace a portion of lost 2020 bonus and LTI value, provided global health and the economy are significantly improved.

In contrast, companies benefitting from, or even performing well despite the crisis, must take care that they are not perceived as profiteers and ignoring the broader community impacts taking place. Paying out maximum bonuses, even if justified by financial results, will be viewed quite negatively.

While it is natural to look to past crises for guidance regarding the present crisis, it is important to heed the differences as well and there is certainly no roadmap for this current one. Companies must take into account their very specific market and operating circumstances and how their workforce is affected, and take great care that they can feel proud of their actions in the future.

About the Author

Matt Turner is a managing director in the Chicago office of Pearl Meyer. He specializes in advising company boards and senior management on executive compensation strategy, incentive plan design, tailoring of performance measures, and the setting of shareholder-focused performance objectives.

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.

About Pearl Meyer

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Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

RALEIGH
(919) 644-6962
raleigh@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.