Post #4: COVID-19 Impact on Retail Industry Incentive Compensation

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Meridian Compensation Partners surveyed 280 major, public client companies in late December to get an understanding on 2020 plan design changes and an early read on 2021 executive pay decisions. This cross-industry survey found that despite significant incentive plan related concerns at the onset of the pandemic, the majority of companies made no substantial changes in 2020 to annual or long-term incentives. Similarly, most companies reported that 2021 design and pay modifications will be modest.

The cross-industry survey provides valuable insight into broad market actions, but retailers faced particularly unique challenges and opportunities in 2020. COVID shut-downs and dramatic shifts in consumer and business behavior have impacted the retail space more directly than many other industries. Even within the retail industry, the impact of the pandemic was extremely variable with “essential” and online retailers having very different outcomes than traditional brick and mortar retailers.

To better understand how actions taken by retail companies differ from the general industry, Meridian isolated the survey responses from 24 retail and similar companies. Note that these results include a mix of companies across the spectrum of retail industry sub-sectors, including apparel retail, specialty stores, food retail, footwear and more.

Key Findings – Similarities to Cross-Industry Results

- ***Only one in four retail companies (25%) made mid-year changes to their annual incentive plan*** – These results are similar to the full cross-industry study, which showed 24% of companies making a mid-year annual incentive plan change. However, over one-half (54%) of retail companies, including those that made mid-year changes to the annual incentive plan, expect to increase the use of discretion in 2020 annual incentive payout decisions.

> ***Meridian Comment****: There are isolated instances of mid-year annual incentive plan overhauls, but in both the retail industry and broader marketplace, these instances were a minority practice. In the majority of situations, companies chose to consider applying discretion at the end of the year to account for the results and outcomes of the full fiscal year.*

- ***A slight majority of companies are considering minor changes to the 2021 annual incentive plan*** – Among the anticipated plan changes, the most commonly reported changes were widening goal ranges and adding non-financial metrics. The cross-industry sample reported similar results. We do expect some retailers will consider two six-month performance cycles in 2021.

> ***Meridian Comment****: Widening goal ranges recognizes the continued uncertainty for 2021 by allowing for a broader range of potential performance and payout outcomes around a stretch target. Non-financial*

metrics can help reward for other priorities not captured directly by company financial results, such as progress on ESG initiatives.

- ***Making mid-year changes to outstanding performance shares is uncommon*** – Only 5% of the retail subset reported making changes to outstanding grants of performance shares, at least thus far, which is comparable to the 7% of cross-industry respondents taking similar actions. However, compared to historical practices, this small minority still significantly outpaces the number of companies that modify outstanding performance shares in a typical year.

> ***Meridian Comment****: Performance shares are commonly evaluated over a three-year time period. As a result, companies have more time to "recover" from COVID-related headwinds. Additionally, companies may want to avoid the accounting and disclosure implications of mid-cycle modifications, which would have attendant risk of being criticized by large investors and proxy advisors.*

Key Findings – Differences from Cross-Industry Results

The retail industry felt the impact of COVID-19 differently than many industries. The following survey results are indicative of this theme:

- ***Nearly four in 10 (38%) retail companies granted executives a special one-time award in 2020*** – This reflects a far greater prevalence than the 21% of cross-industry survey respondents. Among retail companies granting special awards, over one-half (56%) granted the award to all executives, rather than a targeted few.

> ***Meridian Comment****: Many companies have struggled with the desire to motivate and retain executive talent while remaining aligned to shareholder outcomes. This is especially true within the retail industry where share prices are down and many executives are being recruited to other industries with potentially fewer headwinds. As a result, some companies felt the need to grant special incentive awards in 2020 to enhance the retention hooks for specific individuals or all executives.*

- ***One-half (50%) of companies in our sample plan to make significant changes to 2021 LTI design*** – Only 20% of the broad survey sample plan to make similar changes. Among those retailers making changes, the most common action is a greater use of time-vested equity or the introduction of a new financial performance metric.

> ***Meridian Comment****:* Greater use of time-based equity reflects the challenge of setting future financial goals and/or addresses existing retention concerns. New financial performance metrics can allow a company to align compensation with shifting business strategies.

- ***Nearly one-third of companies (32%) anticipate 2021 LTI grant values to increase 10% or more*** – Only 16% of the broad survey sample plan to make similar grant value increases for 2021. Actions considered by these retailers are likely driven by companies experiencing larger impacts to outstanding PSU cycles and reduced share prices, which creates retention concerns.

> ***Meridian Comment****:* Given the potential negative optics of a special one-time awards, many companies have chosen instead to provide increased award sizes within the annual LTI award programs. The increased sizes are generally intended to account for the reduced holding power resulting from multiple PSU cycles unlikely to achieve threshold performance due to the impact of the pandemic.

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