Post #2: Before Implementing Executive Pay Reductions, Retailers Should Have a Plan

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Since COVID-19 started to engulf each and every daily news cycle, the impact on retailers has been inescapable, with a steady parade of store closings, lay-offs, work furloughs, and pay reductions. And the timetable for when the world may return to some sense of normalcy remains elusive. In retail company board rooms across the United States and abroad, there are ongoing discussions about many of the actions already taken by the "early movers" in the industry. That said, it is abundantly clear that some retailers are more impacted than others, some dramatically so.

One COVID-related action already taken by many retailers and being considered by many more – an executive pay reduction - is not always implemented solely as a response to companies' need to conserve cash, nor is it limited to companies' desire to align with other difficult workforce actions, like lay-offs and furloughs. Executive pay reductions can send a powerful message of discipline, good governance and sharing of the burden to the rest of the workforce, as well as to the company's investors and other stakeholders. Such pay reductions can also be a sound public relations move, fostering goodwill among the company's current and potential customers.

So, whether a retailer is financially struggling during this COVID-19 crisis or performing exceptionally well, executive pay reductions may be discussed at the board level for a variety of reasons. However, if a retailer is contemplating a pay reduction for its executives, we believe there are three important inquiries that boards should consider carefully before agreeing to take any such action, and at what level.

What is the purpose of the pay reduction?

Before implementing an executive pay reduction, it is important to have clarity of purpose at the board-level – whether cash conservation, alignment with other workforce actions or shareholder experience, promotion of goodwill and branding, or a combination of these reasons. Articulating a clear purpose can help with internal and external communications and implementation, and better prepare boards and senior management teams to respond to potentially unfavorable market reactions if the pay reductions are interpreted as a sign of financial weakness or distress. Having a clear understanding of purpose can also guide board decisions with respect to if, when and how the company starts to emerge from the economic crisis caused by COVID-19.

What are the material details of the pay reduction, and what collateral issues does it raise?

While there are many levers the board can pull to help protect the company's short- and long-term financial stability, when it comes to a pay reduction, this is often a lever that companies only want to pull once. A pay reduction can be an emotionally-charged issue as it's personal to the welfare and security of the employees and their families. Consequently, before announcing a pay reduction, we believe it is critical to carefully consider the exact amount / percentage of the reductions, the potential impact on the company's P&L, and what collateral issues the pay reductions may raise and how they will be addressed. Potential collateral issues may include bonus plan outcomes, existing contractual employment and/or severance arrangements with respect to pay levels, severance multiples and triggering events (e.g., "good reason"), retirement benefit levels, and life and disability insurance coverages.

What is the expected timetable and/or key indicators for restoring pay levels to their pre-COVID levels?

While most people can appreciate that the economic crisis caused by COVID-19 will impact their lives for some period of time, the most stressful aspect of this disruption is the unknown duration before (hopefully) returning to pre-COVID business activity and consumer spending habits. Whether pay reductions are communicated as being in place for a defined period (e.g., 6 months or the remainder of 2020, etc.) or the reductions are indefinite in duration, we believe it is important for the board to have a clear understanding of the key indicators and circumstances that need to be present before executive pay will be restored to pre-COVID levels. Will the reinstatement of furloughed employees or the re-opening of retail stores trigger restoration of pay levels? If either of these events are gradual actions over time, is there a threshold percentage of progress to be made before executive pay levels will be restored? Is it a return to a quarterly sales threshold? Or are there other circumstances that may drive the restoration of pay levels?

Answers to these questions, and developing a plan for the implementation of pay reductions and their eventual restoration, are often critical elements in successfully communicating the pay reductions to the company's workforce, investors and stakeholders, effectively managing the public relations outcomes, and setting expectations for an eventual return to normalcy.

As we see parts of the world with flattening curves of new COVID-positive cases and retail re-openings (or considered re-openings), it will be important to monitor them for lessons learned in terms of what they get right and what they get wrong. And we hope those lessons will continue to inform us over the coming months.