Compensation Committee Leadership Network

June 2021

CCLN

SUMMARY of THEMES

Keeping pace amid rapid change

The acceleration of innovation has pushed many companies to implement digital strategies faster than they expected. At the same time, board members are keeping a close eye on economic indicators for signs of inflation. Companies are also seeking new ways to explore not just the risks but also the opportunities of enhancing their environmental, social, and governance (ESG) practices. These trends—combined with lingering uncertainty about when the pandemic will stabilize—pose unique challenges for boards and their compensation committees.

On May 17, 2021, CCLN members met with Morgan Stanley's Drew Guevara, Colin Stewart, Michelle Wang, and Kyle McDonnell to discuss how these and related trends are shaping their work.[1] *For a full list of meeting participants, please see the appendix on page 4.*

The following themes emerged:

- **Technology is a disruptive force for every company.** Cloud computing, automation, artificial intelligence, and other tools have already transformed many industries. The meteoric rise in remote work, and the reliance on technology that came with it, accelerated this transformation. Compensation chairs were curious about the extent to which technology is likely to bring change to industries that have not experienced major disruption to date. Mr. Guevara said that while certain portions of industries are likely safe, even the most disruption-proof businesses are susceptible to some form of automation: *"You can't store apples in a data center, but every company in every industry wants to use software to its advantage."* While some end products and services are relatively insulated, the software, logistics, and labor that support them probably are not. Mr. Guevara added, *"Long term, if you don't have a software strategy for your company, somebody else will figure it out. Anything that can be automated will be. Companies that don't recognize these things will be at risk."* The pace of change has caused some members to acknowledge that an advantage that was once viewed as a moat may no longer offer the same protection. One said, *"Frankly, no company is safe."* Some companies are seeking ways to partner with technology companies—or even acquire smaller ones—to help future-proof these businesses. Mr. Stewart said, *"Start-ups are getting co-opted into larger companies. Some of the best acquisitions involve buying something new and putting their product into your existing sales channels. It allows them to grow efficiently."*
- **Low interest rates, high wages, and a booming equity market are causing inflation worries.** The potential variability in the macroeconomy makes this a particularly difficult

time for companies and boards to make long-term plans or investments. Mr. Guevara said, *"There's more money sloshing around than ever before, risk assets have inflated, and actors are chasing after a fixed basis of supply, so all eyes are on interest rates and inflation."* Ms. Wang, a debt capital markets expert, noted that some interest rates have spiked—which may prove to be transitory—and there are indications that spending patterns are changing. *"As normal consumption patterns emerge, people will spend more on things like travel. Supply-and-demand imbalances will correct themselves. Under the surface, wage, rent, and domestic services prices are picking up,"* she said. Some members noted that wages are high and that markets for certain talent are tight. One said, *"Small businesses can't find people to work."* Responding to another member's question about the possible inflationary effect of rising wages, Ms. Wang said, *"Wages are close to pre-cycle highs and will remain high. The Fed takes it seriously and has changed how it thinks about unemployment. It looks at demographics now, for example. It is focused on ensuring that the economy is high pressure as we come out of the pandemic. The Fed doesn't want to tighten things prematurely; it doesn't want to have most people not doing well."* Mr. Guevara noted that technology has played a substantial role in combating inflation: *"Amazon, for example, has a massive deflationary impact."* Mr. Stewart added that regulatory developments in China are worth monitoring given their implications for the global economy: *"Large companies are under pressure in China. Government decrees are changing things. China is trying to compete globally, but domestically it's worried about the things US companies have had to deal with, like anticompetitive concerns."*

- **Economic uncertainty is not causing compensation committees to radically rethink pay plans.** Nearly all members reported adding new metrics to their incentive plans in the last year or two, but in most cases those additions were tweaks around the edges rather than philosophical changes. Meridian Compensation Partners' Annette Leckie said, *"Even with all the disruption in the last year, we've seen relative stability. There has not been much change year to year in the metrics companies are using."* Members said that their committees are, however, exploring ways to reduce volatility, especially in long-term incentive plans (LTIPs). One said, *"Setting three-year goals for the LTIP just isn't possible in our industry right now. We shifted to single-year targets over a three-year period."* Total shareholder return (TSR) remains a popular metric in LTIPs, in part because it does not require committees to set targets, but several members said that they prefer to use relative TSR as a modifier rather than a metric. One explained, *"A TSR modifier on a long-term plan gives us tighter alignment with shareholders. But we like having goals other than TSR to retain management and keep them motivated."* Members are keenly aware that as the pandemic subsides and managers reassess their work-life balance, it will take more than just competitive incentive plans to retain talent. One summed it up: *"You still have to pay big bucks for talented people, but people are also more focused on things like location, access to childcare, and other factors that may not have been as much of a priority in the past."*

- **Companies are seizing opportunities to borrow at lower rates to fund sustainable investment.** While board members often view ESG through a risk lens, members and guests explored how some companies have used it to expand their investor base. Ms. Wang said, *"Sustainability doesn't just sound good to investors; they genuinely think that it's a good strategy. That view will persist, so companies, especially the tech giants, want to be seen as good corporate actors. One way they express it in the capital markets is by issuing an ESG bond."* Companies can attract new investors and ultimately pay lower rates by making commitments about the social or environmental investments they will make with the proceeds. There is typically rigor associated with these bonds as third parties may audit the use of proceeds to ensure companies meet their commitments. In other offerings, Ms. Wang noted, companies issue sustainability-linked bonds in which the proceeds can be used for any purpose but companies agree to pay an incrementally higher interest rate—often 25 basis points—if they do not reach predetermined sustainability goals.

Appendix: Meeting participants

- Homaira Akbari, Temenos
- Gaurdie Banister, Tyson Foods
- Tony Earley, Ford
- Stephen Fisher, Vonage
- Lisa Gersh, Hasbro
- Mirian Graddick-Weir, Booking Holdings
- Marianne Harris, Sun Life Financial
- Worthing Jackman, Quanta Services
- Annette Leckie, Meridian Compensation Partners
- Aylwin Lewis, Marriott International
- Karen Maidment, TD Bank
- Denise Morrison, VISA
- Meg Porfido, Kaiser Permanente
- Virginia Ruesterholz, The Hartford
- Laurie Siegel, Lumen Technology
- Amanda Sourry, PVH
- Matthew Winter, The Hartford

Endnote

[1] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.