Should executives' pay be cut to support employees during coronavirus crisis?

By Chris Blair

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As the business world feels the effects of the coronavirus (Covid-19) pandemic and takes steps to adapt, companies are asking how they should approach their executives' remuneration during this difficult time.

Chris Blair, CEO of 21st Century

Why is it so important for boards and remuneration committees to address this issue? Firstly, South Africa is one of the most unequal societies in the world, with the world's highest Gini co-efficient (a measure of inequality between the "haves and not-haves"). Secondly, business purpose is moving quickly from "making profits for shareholders" to a "new social contract – a commitment to collaboration - to address shared social and environmental problems". This involves the move from 'shareholderism' to 'stakeholderism'...in other words, a move from capitalism to prioritising the protection of life. Thirdly, an executive pay cut would show solidarity with employees who are affected more drastically by wage cuts.

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This article addresses various options that your company could adopt to address the three elements of executive pay:

- Fixed pay or total package (base pay plus benefits),
- Short-term incentives (generally annual pay-outs for past performance), and
- Long-term incentives (generally pay-outs in three to five years' time for meeting future performance targets).

The choice you make will be dependent on your company structure and type of business and would necessarily have to be crafted for your specific company.

Fixed pay

Fixed pay reduction strategies at executive level may be considered so that the company is seen to be empathetic. General staff may have been furloughed, or may be taking shorter working weeks (and therefore earning less pay), or worse still, may be retrenched during the pandemic. The other major reason for implementing a reduction in executive pay would be to drive down costs and to conserve cash.

Fixed pay reduction strategies could include:

- Stopping the investment portion of the executive salaries for the period - this would reduce the executive salary bill by 15%-20%. Some companies have asked their executives to nominate a reduction in salary that they can afford - which ranges from 25% to 100%.
- Executives taking actual salary pay cuts. Global CEOs have led the charge by announcing 100% cuts to their base salaries by the chairman of Disney; Delta Airline CEO Ed Bastian; Marriott Hotels CEO Arne Sorenson and Lyft cofounders John Zimmer and Logan Green. The airline industry, which has been hardest hit by the pandemic, has Delta directors who have elected to forgo compensation for six months and South Western, United and Alaska Air following suit. Disney announced this week that several of its executives will take a pay cut due to the coronavirus pandemic. Locally, Woolworths executives have agreed to take a pay cut of 30% in a bid to help staff that find themselves in “extreme hardship”. Each company’s executives would have to agree on pay cuts that made sense for the unique situation that the company finds itself in.
- Freezing executive salary increases for the next six to 12 months.
- Granting restricted shares to executive salaries in lieu of their cash salaries. However, this comes with the complexity of the share price at grant date - executives could be seen to be taking opportunity of the current deflated share prices at the expense of the shareholders. A simple guideline would be to grant the shares at the volume-weighted average price (VWAP) for the past year or past three months before the share price collapse worldwide.
- If there is a reduction in business activity, companies could implement a policy where executives have to take their accumulated leave over this period so that the executives are available to work once normality returns.

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Short-term incentives (STIs)

Should the executives be paid their short term incentive bonuses? This component of remuneration ranges from 20%-35% of the executives’ total earnings - and can therefore be a large pay-out in the month in which it is paid.

Executives will be receiving bonuses for performance achieved before the coronavirus pandemic and therefore are entitled to these pay-outs. However, the optics would not look good to employees and society in general, and there may not be an understanding that bonuses paid are for past performance, achieved before the pandemic.

Paying out bonuses could also put additional cashflow constraints on the company.

Short-term incentive strategies could include:

- Banking, or freezing, the short term incentive pay-outs for six months to a year and paying out when business has returned to normal. However, it would be extremely important to carefully communicate and describe the pay-outs at that point.
- Settling the bonuses by granting restricted shares at the volume-weighted average price (VWAP) for the past year, or past three months, before the share price collapses worldwide.

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Long-term incentives (LTIs)

The last component of executive remuneration is the long-term incentives. This element of executive pay can be 30% to 50% of total earnings and so is usually the largest component of executive pay. There are two issues regarding long term incentives:

- Granting of new tranches during the pandemic;
- Vesting of previous allocations of the previous three to five years.

Long-term incentive strategies could include:

- Extending the vesting period as restricted shares until normal business conditions return … for the same reasons that short term incentive pay-outs are frozen or banked.
- Granting new allocations, since they have three to five-year performance conditions or restrictions attached - as long as the volume-weighted average price (VWAP) for the past year or past three months before the share price collapse worldwide is used. Alternatively, the shares could be allocated when business returns to normal after the pandemic is over, but this would be similar to allocating before the pandemic occurred.
- Not altering performance conditions that are used for threshold and stretch pay-outs for economic conditions during the pandemic due to the long term value creation nature of this component of executive remuneration.

If executives step up to the challenge of collaboration of a new social contract and the business purpose of preserving human life by walking the talk with employees and stakeholders, it will go a long way to addressing shared social and environmental problems before they manifest in crises like this one.

ABOUT THE AUTHOR

Chris Blair, CEO of 21st Century