Curse of the ‘stick around’ bonus

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THE PROBLEM

Last month Shell and BP roused the ire of investors when they announced plans to award some of their executive directors “retention bonuses”, that is, payments for staying in the job. Companies typically offer such bonuses in the hope of holding on to managers who may have missed out on senior jobs. However, shareholders complain that these awards seldom come with performance conditions attached.

When should companies use retention bonuses, if ever? And are the benefits worth the investor backlash they typically generate?

THE ADVICE

THE GOVERNANCE EXPERT Lucian Bebchuk

Retention bonuses are bonuses in name only. They are no different from paying an additional fixed salary for an additional period. Even if a company and its board become convinced that an extra payoff is necessary to retain a valuable executive, such value should commonly be provided in the form of performance-based pay.

Consider the current plans of Royal Dutch Shell to pay retention bonuses worth about €1m to three executive directors provided that they would stay in the company until 2011.

Taking as given that extra value needs to be provided to keep these executives, why not do so by providing them with some additional equity-based compensation or an award linked to financial performance over the next three years?

Even if such linking of pay to performance required spending somewhat more than €1m, shareholders would be better off. Shareholders need well-performing executives, not merely bodies, and compensation plans should be designed with this goal in mind.

The writer is director of the corporate governance programme at Harvard Law School and co-author, with Jesse Fried, of ‘Pay without Performance: The Unfulfilled Promise of Executive Compensation’

THE EXECUTIVE Jeffrey Diermeier

The investor community in general has been highly sensitised to almost any breaking story that hints at missteps in executive compensation. From the excessive and untimely severance packages of subprime executives to seemingly ever-increasing chief executive pay (whatever the economic climate), the limits of investor tolerance have never been lower. Recent reports of “stick around” bonuses have people scratching their collective shareholder heads. In this

environment, how a board can pay a “thanks for trying” premium at a time of such intense scrutiny of executive pay is astounding. The presumption should be that their current arrangements are adequate.

Does this suggest that added pay is required for executives to work for the newly minted chief? At a minimum, such payments should be tied to a two- or three-year vesting.

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THE ACADEMIC Edward E. Lawler III

Retention bonuses may provoke an investor backlash, but that doesn’t mean they are a bad practice. In fact, under some conditions they are a very good practice. Bonuses can affect job performance and retention. For a bonus to affect performance, it must be at least equal to 10 per cent of total remuneration. Increasing performance has an obvious payback and, as a result, performance-based bonuses are easy to defend.

Reducing turnover can have multiple paybacks. The price of losing crucial talent is high, and often exceeds the yearly salary of an executive. If the executive switches to a rival, it can instead strengthen the rival company.

To avoid losing critical talent, organisations need to pay at or above the market for top performers. Paying retention bonuses is one way to ensure pay is at – or above – market rates.

The best approach is usually to pay retention bonuses out over several years so that there is an incentive for executives to stay. Investors may not like retention bonuses, but they will be far unhappier if their organisation loses crucial talent and incurs turnover costs.

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THE PR Tim Metz

To communications professionals, this budding trend towards “one-off” retention bonuses, as they are described, walks and talks like a contradiction in terms. And clearly it smells that way to restive shareholders in the City and on Wall Street. For if they truly are “one-off”, how can they be retention tools? Surely, selling them to professional investors as such would be no easier these days than selling them an exotic new breed of credit derivative. That is not to say a case cannot be made for granting an extra bonus to help retain a valued executive’s loyalty. But this has to start with a strong case for retaining the recipient. Credibility, though, demands that you lose the “one-off” language. For, as T. Boone Pickens, the savvy corporate raider of the 1980s, once said of himself, most investors and certainly the institutions kicking up the dust over one-time retention bonuses “didn’t ride into town on a load of watermelons last week”.

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