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Navigating Incentive Decisions in Times of Uncertainty in Southeast Asia and Beyond

Firms should proactively start thinking about adjusting their short- and long-term incentive schemes to better prepare for an uncertain economic future and ensure they are well-positioned for the road to recovery.

While the humanitarian and economic toll of the COVID-19 global pandemic continues to grow, many organizations have shifted their focus from crisis management and business continuity to planning for a safe return to the workplace and a new normal for business operations. This also means planning for an inevitable economic downturn and controlling costs in an unstable environment. Against this backdrop, a key question has risen to the forefront — how do we navigate incentive decisions during times of uncertainty?

Many large, leading companies across Southeast Asia are making headlines regarding recent pay cuts and delayed bonuses in response to the COVID-19 pandemic, which has created pressure for other firms to take similar actions. However, finding the right compensation method for your firm can be challenging. It's important to look beyond the noise of the media and what the said "majority" are doing and respond based on the unique circumstances, data and facts that are relevant to your business.

Within the Asia-Pacific (APAC) region, results from Aon's third COVID-19 pulse survey, published on May 6, 2020, revealed that 80% of companies are moving away from the crisis management phase and are now focusing on business continuity or planning for the future. Among these companies, 14% have adjusted their short-term incentive (STI) targets and 25% of companies are making adjustment to their long-term incentive (LTI) plans. We further explored these issues during our recent webcast, *Navigating Pay Decisions During Uncertainty*.

This article takes a closer look at the implications of an uncertain economic outlook and shares tips for how to recalibrate your short- and long-term incentive strategies to position your firm for future success.

Tip #1: Move out of Reactive Mode

Every company has been affected differently by the COVID-19 pandemic. Before making any drastic, knee-jerk decisions, it's essential to carefully think through the current state of your business and ask yourself questions like:

- How significant do any compensation changes need to be and for how long should they be in place?

- What are our contingency plans for different career and environmental scenarios? Will they be enough to support all employees?

- With potential incentive reductions, how do we continue to motivate employees to drive performance?

To weather the storm, HR and business leaders must think ahead. As companies continue building resilience by protecting and supporting their people through health initiatives, it's important to start also planning for the longer-term journey. Look toward the next six to 18 months and focus on the cautious redeployment and investment of employees to targeted business segments through agile and entrepreneurial opportunities and performance-based rewards.

And the final stage – lead the restart. Even though there is still time, having a predictive mindset to look beyond the 18-month mark is key. Anticipate deeper and accelerated structural changes to incentive schemes and the way we work and make changes to prepare your firm accordingly.

Tip #2: Consider Short-Term Incentive Plan Changes Now

Uncertainty will continue to dominate the business landscape for the foreseeable future. Recovery could take many shapes and forms, contextualized by a company's specific industry and operating circumstances. Therefore, living in reactionary mode will not be feasible in the longer term, and companies need to start considering proactive measures and make changes to their incentive strategies and features that will help navigate the unique recovery journey for their organization.

Now is the time to introduce fundamental features into your short-term incentive (STI) design that will help guide the path to recovery. Here are some simple steps to follow and initial questions to consider when adjusting STI plans:

- **Prioritize critical employees and high performers –** As the bonus pool shrinks, there is a more urgent need to truly differentiate your most critical employees and enhance your ROI on incentives. Companies cannot afford to just talk the talk when it comes to differentiation. Your most prized employees are the ones who will have the highest probability to make a lateral move to another or competing organization.

    - **Ask yourself –** How do we differentiate and motivate our critical and high performing employees?

- **Review your corporate scorecard for relevance –** For companies who were previously focused on growing market share and top-line measures, there is now a need to shift your focus towards the bottom line. This will help drive prudent cost management and sustainable profit margins to ensure survival. Companies have also started to pay more attention to cashflow and liquidity ratios to maintain solvency.

    - **Ask yourself –** What changes do we need to make to our scorecard to ensure continued relevance?

- **Extend horizon of STI and introduce affordability tests and caps –** Affordability caps can help ensure sustainable incentive cost management. Determining the right cap for your specific company is key. And remember – it is important to safeguard from overpaying as a result of any fluke achievements during recovery. However, introducing a cap can also have a demotivational impact on employees. Therefore, it may be preferable to adopt deferred bonuses to spread out the cashflow impact, enhance retention, and continue to motivate by keeping the same pay opportunity for good performance during tough times.

- **Ask yourself –** How do we choose the appropriate cap for our company? Can we defer bonuses rather than cancel them?

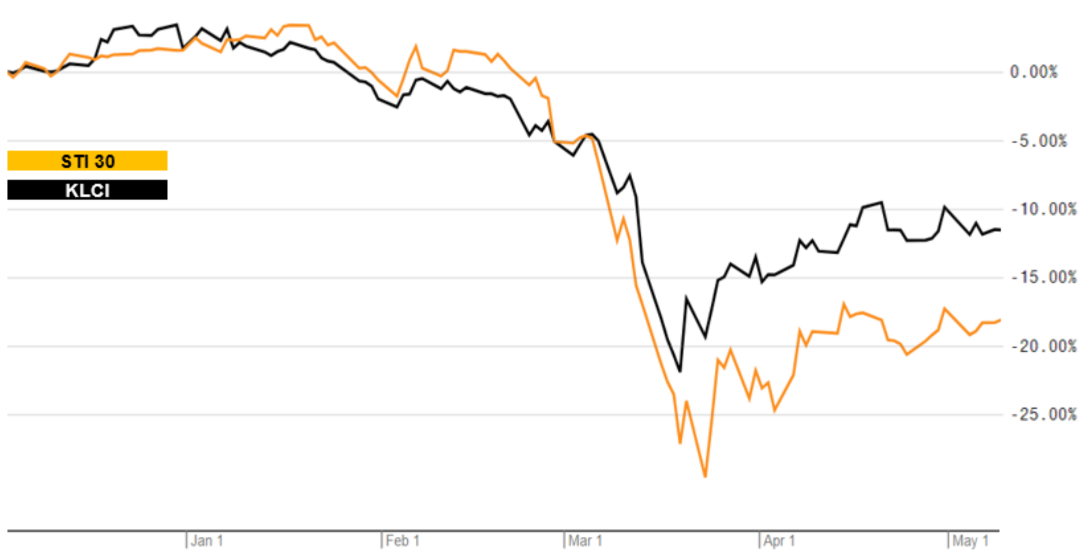
It's essential to proactively manage STIs on an ongoing basis to help develop agile plans that can quickly differentiate your firm during uncertain times. Considering the points outlined above and thinking through specific questions will ensure you are on the right path to recovery — a necessary task to conquer before tackling the longer-term journey.

Tip #3: Maintain a Proactive Approach to Long-Term Incentives

As the chart below illustrates, the price for the Singapore Straits Times Index (STI 30) has dropped by approximately 20% over the past five months. Performance share plans, with vesting conditions based on total shareholder return granted this year, already look unlikely to meet their performance hurdles. Similarly, the share price for KLCI companies in Malaysia has dropped by more than 10%. Among the top 50 listed companies with active ESOS plans in Malaysia, 75% of their stock options are out of money.

Figure 1

Stock Market Performance for Singapore and Malaysia from January to May 2020



Source: Aon Proprietary Database

With such weak share price performance in Southeast Asia equity-based incentives have clearly lost some of their power to retain and motivate talent, thus we then face the question — how relevant are equity awards at this time? And is the right response for firms to switch to cash plans?

According to our recent COVID-19 pulse survey findings, 66% of firms in Asia, Africa and the Middle East are not planning to change their long-term incentives (LTI) or consider it too late to adjust their equity awards, despite the severity of the situation.

While it may seem counter-intuitive for companies to not change anything in the face of current market conditions, many firms are adopting a wait-and-see stance for the time being. The type of response required will depend on the recovery path occurring in each company's specific geographical region and industry. Recovery methods are not one size fits all. In fact, recovery comes in many shapes and forms and it's important to find the corresponding suitable approach for your specific organization. For example:

- **Introduce relative total shareholder return as a KPI –** Introducing relative total shareholder return as a KPI provides payout opportunities, even in a down cycle. It also prevents windfalls from starting at a lower base and reduces uncertainty when it comes to establishing multi-year goals. This is best suited for economies that are experiencing "U" and "V" shaped recoveries.
  - **Ask yourself** – How do we select the right peers for our company?
- **Introduce a tier below threshold performance –** This measure addresses employee motivation by adjusting baseline performance to reflect new realities, while also protecting shareholder interest and keeping target and stretch levels unchanged. This approach is best suited for firms experiencing "V" or "W" shaped recoveries.
  - **Ask yourself –** How should we determine this additional tier? How long should it stay on?
- **Repurpose to a transformation LTI –** For some companies, recovery may be "L" shaped as the sweeping changes render their industry obsolete. In this case, there is urgent need to transform the fundamental business. It then makes sense to reorient the current LTI scheme to look beyond the current situation and to incentivize for longer term transformation.
  - **Ask yourself –** How do we define successful transformation outcomes?

Finally, while we advocate for taking a proactive stance toward considering changes to equity awards, it is important to remember that changes, especially for outstanding grants, will likely trigger accounting and legal issues that will need to be addressed.

Tip #4: Review Governance Mechanisms

Whether focusing on short- or long-term incentives, plan design changes must always be complemented by governance mechanisms that allow for agile and tailored actions in the face of uncertainty. These governance mechanisms should give latitude to remuneration committees to exercise the right level of discretion to ensure that pay outcomes are commensurate with the performance delivered, taking into account the contemporary circumstances.

Consider following these five steps when addressing challenges, which the current environment is placing on incentive programs:

1. **Flexibility on the performance period**: Extend the performance period for equity and other long-term incentives.

2. **Flexibility on the vehicle to deliver incentives**: Repurpose your annual bonus into longer-term retention equity grants. For example, if you planned to pay out cash in the current year, split a portion of this into a longer-term equity grant to help with cash management in the shorter-term.

3. **Agility on target-setting**: Separate the impact of crisis-related gains/losses on incentive targets. See if you can adjust targets on a rolling basis to account for the impact of the COVID-19 pandemic to ensure that they are still realistic and achievable.

4. **Pre-set criteria for exercising discretion -** Ensure discretional adjustments for bonus payouts and LTI vesting are based on pre-agreed criteria. Determine the thresholds that need to be met for exercising discretion to prevent disputes down the line.

5. **Flexibility to differentiate payouts –** Top up bonus payouts for critical roles and high-performing talent who are deserving. They will be the ones who lead your company through this recovery.

Next Steps

As we move forward, start by revisiting fundamental elements of your short-term incentive plans and don't be afraid to introduce new methods for your long-term incentives, such as using relative total shareholder return as a KPI or adding a tier below threshold performance level. All changes and governance practices should be tailored to your organization and its specific needs. No matter what shape recovery takes, by carefully considering your options and asking yourself key questions along the way, your company will build the resilience needed to lead the restart for the future of work.

To learn more about the impact of the COVID-19 pandemic on businesses in Southeast Asia and how we can assist, please contact one of the authors or write to rewards-solutions@aon.com.

To read more articles on how rewards professionals can respond to the COVID-19 pandemic, please click here.

To download complimentary results of our latest pulse survey on Setting the Stage for a Return to Work and the New Normal, please click here.

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