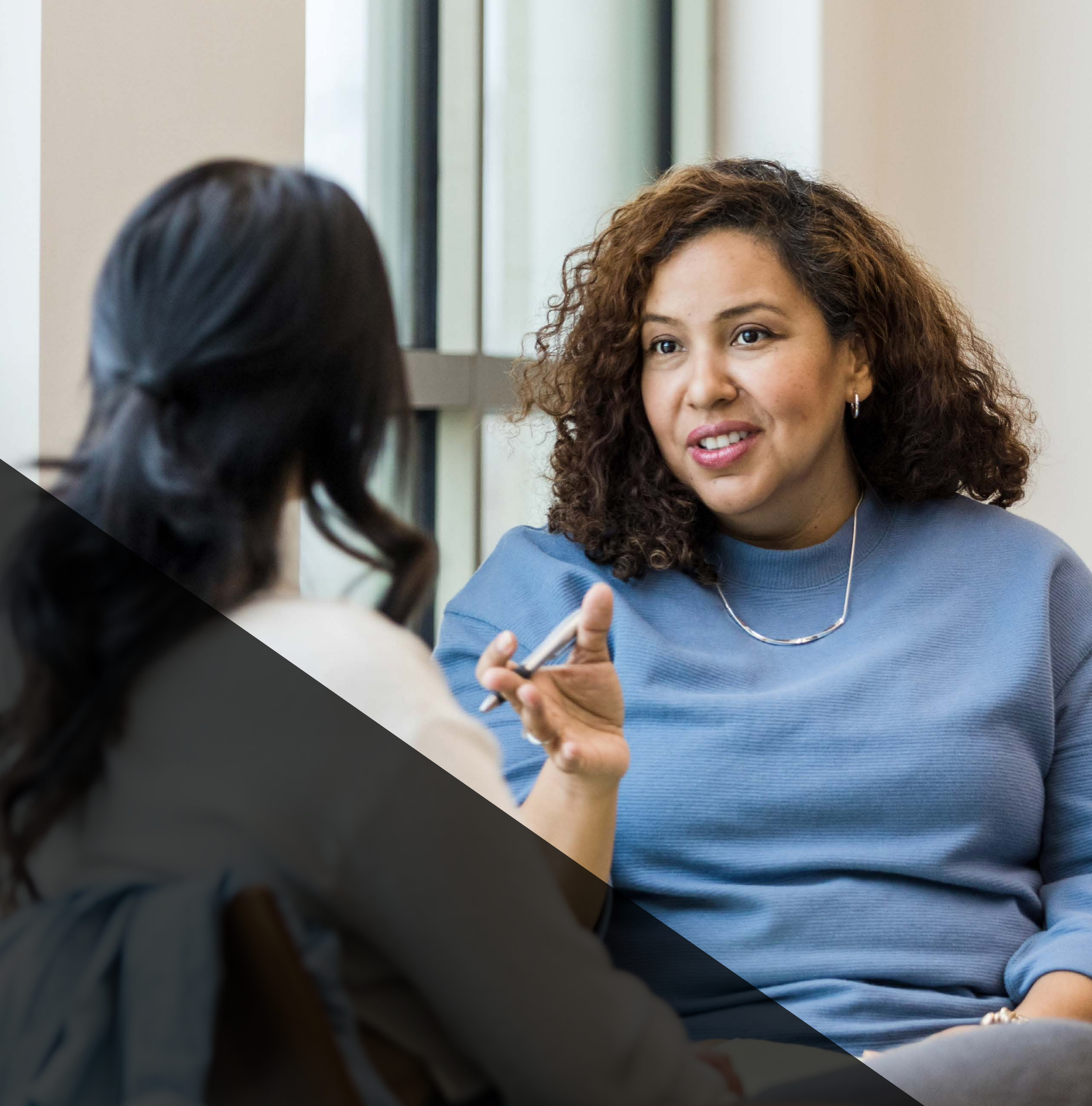

COMPENSATION COMMITTEE PRIORITIES FOR 2024:

# Navigating the Latest Compensation Trends

Compensation committees (CCs) face a critical and urgent challenge: designing competitive compensation strategies in a world where the economy is unpredictable, leader accountability is expected to go beyond the bottom line, and sought-after talent is scarce. So scarce, in fact, that according to the BDO 2023 Spring Board Survey, 14% of directors now view talent acquisition and retention as their most formidable business risk, and 92% say talent shortages pose some or a significant risk to the company. Continually managing talent retention and accountability to a broadening range of stakeholders requires that CCs boldly embrace their expanding responsibilities and stay laser focused on ever-shifting trends. To unlock the true power of compensation, applying savvy approaches is non-negotiable.

| **LOOKING BACK*** | **FUTURE DIRECTION** | **GENERAL STAKEHOLDER SENTIMENT** |
|---|---|---|
| Total direct compensation for CEOs and CFOs increased significantly in 2021 (22% and 21%, respectively), but leveled out in 2022 (8% and 5%, respectively).<br><br>Annual bonuses decreased due to the impact of the current economic climate, but total cash paid remained flat. | Employers are still planning modest raises in compensation budgets, with projections between 3% and 4% for total salary increases. | Say on Pay support at S&P 500 companies increased for the first time in five proxy seasons, indicating stakeholder satisfaction with compensation plans. |
| 2022 saw a shift toward Long-Term Incentives (LTI) playing a larger role in the mix of pay to support retention and long-term growth. | Compensation packages are focusing on incentive compensation and prioritizing a complete benefits package including a comprehensive human capital experience to enhance retention and job satisfaction. | Directors recognize the strategic priority of attracting and retaining talent, finding the balance between competitive compensation and benefits, along with driving and rewarding behaviors that align with stakeholders' expectations. |

*See the **2023 BDO 600 Studies of CEO, CFO and Board of Director Compensation Practices** of 600 mid-market public companies for a detailed analysis.

## UNLOCKING THE POWER OF INCENTIVIZED COMPENSATION: ALIGNING REWARDS WITH RESULTS

A recent survey by BDO, Corporate Board Member (CBM), and Diligent revealed that 57% of directors recognize the importance of clearer alignment between compensation and corporate strategy to retain key leaders. A competitive advantage in the CC's crucial role of attracting and retaining top talent is incentive-based compensation. By aligning compensation with an organization's strategy, goals, and objectives, CCs can unlock the power of incentives and drive exceptional performance.

Traditionally, incentive compensation has been limited to the executive level — but that's changing, with a growing trend toward extending incentives to a broader range of employees. This not only promotes pay equity but can increase employee retention while reducing the cost of having to attract new professionals. By embracing this shift, CCs can create a culture of meritocracy to motivate employees at all levels to contribute to the company's success.

Effectively structuring incentivized pay requires CCs to consider best practices that bring results, including:

- **Driving behavior and long-term shareholder value:** Incentive compensation should align with the organization's strategy and identify metrics and goals that drive behaviors that create value for shareholders. These expectations should be communicated clearly, both internally to employees and externally to investors/stakeholders. By linking compensation to strategic objectives, CCs can further inspire employees to support the organization's goals.
- **Striking a balance between short- and long-term metrics and compensation:** A balanced approach could mitigate some of the uncertainty in today's flattening economic environment. Our recent collaborative CBM survey indicated that 59% of directors have strategically shifted toward long-term incentives (LTIs), such as performance-based equity awards or restricted stock units (RSUs). Why? Because they help mitigate the risk of losing key leadership team members — and they help align compensation with sustained performance.
- **Considering nonfinancial goals:** While financial metrics are essential and have traditionally been favored by investors, incorporating nonfinancial goals can provide a more holistic view of performance. However, deliberate consideration and specific metrics, reasonable payouts (often maximized at 100%), and clear communication are key to ensuring that nonfinancial compensation tools are effective and viewed positively by investors.
- **Adapting to the changing landscape:** In today's volatile economic environment, CCs must anticipate a wider range of incentive-based compensation structure factors. Flexible compensation structures allow organizations to navigate uncertainty while holding participants accountable for factors under their control. However, caution should be exercised to avoid excessive reliance on discretionary analysis and decreases in performance targets, as these can be perceived negatively by stakeholders.

Embracing these best practices, CCs can unleash the full potential of incentive-based compensation and create a culture of performance and engagement to better position themselves competitively in the talent market with the support of shareholders.

## BRINGING VISIBILITY TO STAKEHOLDERS VIA TRANSPARENT DISCLOSURE

The role of CCs in helping their organizations navigate a dynamic regulatory landscape and comply with disclosure requirements is crucial. With stakeholders demanding greater pay transparency and insight into human capital strategy, clear and transparent communication is critical to their understanding of the intricacies of compensation design and the rationale behind key decisions.

The newly effective Pay Versus Performance, clawback, and share repurchase disclosures require the development, scrutiny, and review of corporate compliance policies. They also necessitate consideration of the scope of the regulations together with an evaluation of the company's ability to perform specific calculations triggered by events (e.g., a restatement requiring compensation clawback) in a timely, accurate manner. Collaboration with outside counsel and auditors can help support compliance, while working with the Audit Committee enables a greater understanding of available data, the controls around the data, and the story it tells as new regulations arise. The creation and review of these policies, procedures, and data may ultimately impact how compensation is being designed.

With the increase in compensation disclosures, directors should be familiar with ways to analyze and explain compensation, including:

- Summary compensation table pay
- Compensation actually paid (CAP)
- Realizable pay

These analyses tell different stories — understanding the comparisons among them is essential.

Compensation Discussion and Analysis (CD&A) within the annual proxy remains the prime opportunity for companies to tell their story, including their focus on compensation, sustainability, and Diversity, Equity, and Inclusion (DEI) efforts. It's a chance to move away from boilerplate language and articulate what the company is doing, why they have taken certain actions, and how they can demonstrate their impact to shareholders.

## HUMAN CAPITAL MANAGEMENT: FROM TALENT ATTRACTION TO SOCIAL IMPACT

For many organizations, the expanding role of the CC now encompasses oversight of Human Capital Management (HCM) — essentially the attraction, retention, and development of critical talent, as well as addressing social risks and the opportunities they bring. In fact, **a review of fiscal year 2022 proxies** revealed that half of Fortune 100 company boards and 40% of S&P 500 boards have incorporated HCM into the responsibilities of their CCs.

Additionally, global pay policy and pay equity have gained prominence, with increased calls for disclosure on pay disparity reporting. Labor issues and human rights proposals are gaining momentum, with an increase in support for freedom of association proposals and enhanced reporting requirements under the Corporate Sustainability Reporting Directive (CSRD).

However, **according to the *Spring 2023 BDO Board Pulse Survey***, 58% of directors surveyed believe that boards could have a more impactful oversight of management's human capital strategy. With HCM issues, such as culture, playing a vital role in attracting and retaining talent, defining and monitoring the desired corporate and board culture has been recognized as a guiding principle by the National Association of Corporate Directors.

So, how can compensation committees manage HCM challenges? We recommend that CCs consider the following levers to pull into their HCM strategies:

- Establishing intentional oversight and accountability around human capital matters including culture, employee welfare, pay equity, and diversity
- Incorporating transparent career pathing and succession planning strategies
- Extending career advancement and learning opportunities to help proactively identify high-performing individuals as this can lead to greater job satisfaction and talent pipeline optimization (with 74% of directors acknowledging their agreement)
- Curating thoughtful benefits packages representing the needs of each unique workforce
- Optimizing remote and hybrid work arrangements
- Responding to technological innovation by reskilling the organization's workforce

As the compensation committee's HCM role continue to expand, staying informed and responsive to talent and social issues will enable the committee to contribute to the organization's sustainability and success.

## LOOKING AHEAD: PAVING THE COMPENSATION COMMITTEE'S PATH TO SUCCESS IN THE TALENT MARKET

Looking ahead, CCs must rise to the challenge of attracting and retaining top talent while effectively managing costs. To achieve this, it is imperative for CCs to embrace the power of incentive-based compensation, align it with strategic goals, and foster a culture of meritocracy within their organizations. Additionally, staying ahead of evolving regulatory requirements and optimizing HCM strategies will be essential. By taking these proactive steps, CCs can position their organizations competitively in the talent market and drive sustainable success in the future.

For questions about the latest compensation trends and the evolving role of compensation committees, contact the BDO Center for Corporate Governance.

- **BDO Center for Corporate Governance – *Compensation and Human Capital Committee***
- Report: ***BDO 600 Board and Executive Compensation Studies***
- Webinar: **2023 Board Compensation Trends and Year-End Planning Considerations**
- Survey: ***Spring 2023 BDO Board Pulse Survey***
- Podcast: ***Does Your Board Comprehend the New Reality of Work?***

# Contact Us

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