As the Life Sciences Sector Soars, It's Time to Examine the Risks and Rewards of Your Annual Incentive Plan

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Introduction

Valuations for life sciences companies, especially in the biotechnology and diagnostics industries, continue to soar, boosting stock prices and investment. Fortunately for employees, the good news does not end there— annual incentive payouts are also on the rise.

With fresh bonus checks for the 2014-2015 cycle beginning to hit bank accounts (and our survey databases) now, we decided to look at past and present payout levels in the life sciences sector to determine whether or not this is a good time for companies to reexamine how they set their performance metrics and performance goals.

According to results from the Radford Global Life Sciences Survey, most companies awarded at, or above target, short-term incentive bonuses for the 2013-2014 cycle, the most current period for which robust results are available. In fact, as the table below illustrates, median bonus payouts exceeded 110% of target for each of the executive officer, director and manager levels for employees working in Europe at both European-headquartered and US-headquartered companies.

Median Actual Bonus Payouts as a Percentage of Target (2013-2014 Bonus Cycle)

Radford Level	All Employees in Europe	European Company Employees	US Companies with European Employees
Executive (E7-E8)	114%	112%	132%
Director (M4-M5)	114%	113%	117%
Manager (M2-M3)	126%	126%	121%

Among the many stout numbers cited in the table above, a few items stand out. First, executive officers at US-based companies enjoyed bonus payouts well above target and well above their counterparts at European-based companies. Next, we observe that Managers received larger payouts (as a percentage of target) than Directors at all types of companies. This last point indicates a very strong desire on the part of companies to reward and retain front-line managers, especially in an environment where competitor firms are increasingly willing and able to attract critical talent.

With those healthy results from 2013-2014 in mind, we believe companies should take time soon to carefully consider how today's buoyant market is impacting annual performance targets and potential performance outcomes. As economic cycles ebb and flow, performance metrics and performance goals should be evaluated on a regular basis to make sure they are challenging enough, competitive with the market, and appropriately aimed at achieving strategic objectives. For example, companies may want to explore greater use of milestone-based metrics (e.g., clinical trial progress or regulatory approval), consider "outperform" goals based on achieving meaningfully better performance than a specific set of peer companies in a "rising tide" market that could be lifting all boats.

To help put recent annual incentive results into perspective, and to further reinforce the importance of evaluating forward-looking targets, our team pulled together data on bonus payouts from ten years ago. As the table below illustrates, payout levels in 2013-2014 were very high relative to past years. While it's true that the life sciences sector was not as energetic in 2003-2004 as it is today, the global economy was in a similar mode of growth and recovery.

Median Actual FY14 Bonus Payouts as a Percentage of Target (2003-2004 Bonus Cycle)

Radford Level	All Employees in Europe	European Company Employees	US Companies with European Employees
Executive (E7-E8)	103%	103%	117%
Director (M4-M5)	102%	105%	96%
Manager (M2-M3)	100%	100%	97%

Historical data highlights the fact that we are in somewhat unusual times when it comes to sector performance and bonus results. This makes it all the more important to look forward and ask the right questions about the appropriate relationship between risk and reward.

Conclusion

Although real-time data on 2014-2015 bonus payouts is only starting to arrive now, we expect to see another year of well above target results. This raises important question about plan design: Should above-target payouts be the norm, even in years when performance is very strong? And how quickly should companies seek to raise performance hurdles when markets rise to reward growth above a 'base rate'?

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