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Podcast Transcript: Winning the Talent War in Life Sciences

Kelli McCauley: As the talent wars continue their fierce march across most industries, leaders are actively innovating compensation approaches to attract and retain talent. What strategies are being used in the life sciences, biotech, and medical devices industries? That's what we're talking about in today's podcast. Welcome. I'm Kelli McCauley, producer of The Director's Cut podcast for Corporate Directors Forum and president of McCauley & Co., where we help leaders in high growth industries align their team and get results. Today, our esteemed guest is Mike Esser, managing director with Pearl Meyer, and highly regarded expert on compensation. Mr. Esser is going to weigh in on what's trending in life sciences, biotech, and the medical devices world. Welcome, Mike. Thank you so much for being our guest today.

Mike Esser: Thank you for having me Kelli. Appreciate it.

Kelli McCauley: So Mike brings more than 25 years' experience as an advisor to boards and senior management in executive and board compensation. Compensation strategy, annual and long-term incentive, and equity plan design. Mike, you shared with me that executive compensation in life sciences, biotech, and medical devices is often considered as outliers. Meaning perceptions are that pay is higher, that equity can be off the charts, I have some neighbors that had happened with, and the competition for top talent is tougher. So from your perspective, let's address these myths, realities, and the in between.

Mike Esser: That sounds good. And before we jump in, I'd say in large part these are realities, right? A little bit of myth and some of both. Compensation levels tend to be higher in the sector, but cash compensation is only moderately higher, but it's growing more rapidly than other industries.

Kelli McCauley: Right.

Mike Esser: Equity compensation, as you suggested, off the charts, but there's a reason for that. And the vehicle that's used is much riskier than other industries. And then the competition for talent is hot in this sector, as in many sectors, but there are reasons for that. And then kind of broadly before we get too much further, a little caveat in terms of... As you described it, Kelli, you're exactly right. Life sciences covers a wide group of subsegments, whether it's biotechnology, pharmaceutical, diagnostics, contract research organizations, medical device. So it's a little difficult to generalize for all those industry subsegments when we're talking about practices and compensation levels, but we'll do our best.

Kelli McCauley: And people listening and watching will certainly get ideas.

Mike Esser: Yeah, I think that’s right.

Kelli McCauley: Let's start with corporate directors, either those very familiar with the life sciences market or those new to such a board. What should they know about executive pay trends right now in this industry?

Mike Esser: Yeah, great question. I think a couple of things that we touched on earlier, cash compensation is higher, but only moderately. But it is growing much more rapidly and that's due to a couple of factors. Labor market dynamics. So it's a competitive market for R&D and clinical talent, as well as experience with commercialization for a lot of these companies. They're still in the clinical phase and are not really producing product, let's say, for the market as a whole. And then against that backdrop, there's increasing competition really from kind of current market participants, as well as new entrants, whether they're diagnostics firms that really thrived during the last two years with COVID, as well as SPAC-backed organizations and companies that are becoming public now.

In terms of other things that directors ought to know, particularly if they're new to this industry, pay levels can and are often unrelated to the size of the organization, whether it's due to revenue, whether you're measuring revenues or market capitalization. And there are reasons for that. One, so many of the companies in this segment are pre-revenue, clinical phase. So, there is no kind of revenue boundary or scaling of compensation. The compensation really is set at what market pay levels are for similar organizations, many of which are pre-revenue. And that can be a little bit different than other industries for a director that hasn't been exposed to life sciences.

Kelli McCauley: Oh sure.

Mike Esser: And that has impacts on their jobs as compensation committee members, in terms of it impacts peer group formation and development. Who do we compare against? It's not usually like-sized companies, but maybe like-staged companies. Companies at the same stage of our organization in terms of whether it's clinical trials, phase one, phase two, that sort of thing. It also impacts bonus plan metrics. Bonus plans in other industries are often set around hard financial metrics, whether it's revenue or profitability. And in this sector, we don't have those same metrics, right? We may be pre-revenue. Profitability isn't even on the horizon for several years. So the bonus metrics do tend to reflect strategic goals, individual goals, clinical milestones, that sort of thing. A lot more discretionary or subjective than hardwired financial results.

Kelli McCauley: And what are you seeing in terms of competition for top talent in this area and for C-suite talent more broadly?

Mike Esser: Well, competition for talent is absolutely hot due to the labor market dynamics and new market entrances, as we talked about. In addition, turnover is pretty high. It was about 15 to 20 percent last year.

Kelli McCauley: Wow.

Mike Esser: Which is historically pretty high. You tend to see that maybe in technology segments, but other segments have a lot less turnover. I guess not surprisingly, that combination has created an issue, right? And upward pressure on pay levels for many life sciences companies. I'll pause there though and say it's more acute at lower levels of the organization. I'd say maybe director level and below, and in certain areas. R&D, technical business development types of positions, so certain functional areas within the organization. It's somewhat less of an issue at the senior executive level, except for pockets around commercial, or chief medical officer, chief clinical officer, chief commercialization officer, that those types of positions are very high. I think what we do see and what we're starting to see more of, not so much in 2020, but in 2021 and going forward, is some retention grants on a broad basis. And by that, I mean additional equity grants kind of over and above what they annually receive to particular areas within the organization are facing increased competition in this environment.

Kelli McCauley: And is this usually designed with the board and a compensation consultant like you, HR? How does that typically work?

Mike Esser: Yeah, it's usually, I would say, a collective design or a collective effort, I should say. Oftentimes, it's driven by board or management. Management coming to the board and saying, "Hey, we've got to do something because we're facing a lot of competition. We can't hire for the positions that we need to. And by the way, when we bring in somebody at a particular level, say a new executive, they're much more highly paid than some of our existing executives in more senior roles." Right?

Kelli McCauley: Wow.

Mike Esser: So it requires kind of a reset and maybe prompted by management, but then the compensation committee deals with it. The consultants also assist the company and the committee in carving a path forward for the organization.

Kelli McCauley: Are there any last tips you'd like to give to our audience about compensation attracting and retaining talent?

Mike Esser: Well, I think you asked about similarities and differences in equity and I think the audience would probably like to hear a little bit about that. And as we mentioned at the top, it is quite different and the levels are quite a bit high. Whether you look at them from a dollar-value perspective or number of shares, equity grants in this sector are much higher than other sectors. And it's important for directors to know this too, especially if they're not typically involved or if they're new to the segment in terms of being on the compensation committee. Equity participation, as well, is deeper within these organizations than other companies—maybe a lot like software companies are where they drive equity down to much lower levels. And there's a reason for that.

It represents non-cash compensation. So for pre-revenue companies or the very focused on cash burn, it is a way to keep competitive on a compensation level without having to spend cash. You're spending equity, or equity is the form that it's granted in—doesn't weigh on cash. As a result, well, the principle vehicle that is used is also different. This life sciences segment largely uses stock options. And the rest of the market and other industries and segments have moved away from stock options over the past 15 years and migrated toward kind of a combination of restricted stock and performance contingent shares. There aren’t a lot of performance contingencies in this segment for some of the reasons we talked about earlier. There are no financial metrics to hang your hat on with respect to, how are we going to perform two or three years from now? Also, that time horizon's pretty long.

I guess the common currency in equity is stock options. And those tend to be much riskier, especially in this segment where it's a pre-revenue company. So there are many cases that option value, that kind of promise of the company's value over time, may never materialize. Or if it does, it's often kind of feast or famine, goes up and down very, very quickly and very significantly in terms of kind of volatility in stock price going forward. So that combination of using options and driving it broader and deeper into the organization, you wind up burning through a lot more shares in this industry, in your equity plan than other segments in other industries. I'd say on average, it's about 5% annually in terms of common shares outstanding get granted through executives and management employees in life sciences. And that's about twice to three times as much as other industries. Other industries are hovering around one to two percent per year. So, just gives you a flavor for... On that front, it is a reality. Equity compensation is much higher, but there are reasons for that.

Kelli McCauley: Sure. On that note, Mike, you've given us such valuable compensation strategies and insights to attract and retain talent, plus discuss the realities, the kind of myths in life sciences, biotech, and medical devices. And I'm sure that leaders in other industries listening will be able to apply some of these tactics into their situations and also get the right advisors to help them along this front for sure. So, thank you for generously sharing your expertise with us today.

Mike Esser: Thank you, Kelli.

Kelli McCauley: To learn more about Mike Esser, you can reach him at mike.esser@pearlmeyer.com. And for details on Pearl Meyer, the leader in executive compensation consultation, go to pearlmeyer.com. I took a peek this morning and their website has terrific resources, articles, and predictions on compensation. For more podcasts like this, visit mccauleyandco.com and subscribe. To hear about critical board member issues, challenges, and solutions like those discussed in today's podcast, go to directorsforum.com. Until next time, we wish you the best on positively impacting the organizations and boards that you lead.