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Mega Grants: Mega Motivator or Expensive Moonshot Bet?
Only four CEOs got the grants in the past year

By Amanda Gerut
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CEOs and compensation committees are continuing to weigh the impact of mega grants — equity awards consisting of multiple years' worth of grants rolled into one.

While the grants remain a rarely used incentive scheme amid the market volatility of recent years, sources said the grants can be beneficial tools for boards that want to motivate executives to transform a company. However, directors should understand the challenges a company would face in engaging with investors and proxy advisory firms on the performance targets in the grants and whether an executive will see true downside if they don't hit goals.

Sources said the grants should be tied to times when a company is dealing with critical strategic change and the board wants to jump-start a transition. The problem with the grants, however, is that they require a company to use much of its resources at once. If it doesn't pan out, it can create significant risk and put additional pressure on the board.

At the same time, if a board needs a CEO, founder or key executive to remain with the company, a mega grant creates a strong incentive, said Tony Greene, senior vice president at executive benefits consulting firm NFP.

"It's a very expensive event when you start losing people," he said. "They know your business; they have institutional knowledge; and they understand how everything works."

Consulting and data firm Equilar defines mega grants as large equity awards intended to replace future annual equity grants. Typically, the grants are two or three times more than a regular annual grant, and they are usually awarded in lieu of other grants for a lengthy period of time as a way of front-loading stock awards or units at a lower price. Some grants are worth seven- or eight-years' worth of annual grants at the larger end.

Only four S&P 500 CEOs received mega grants in the past year, and one was an extension of a previously granted award, according to data from Equilar. The grants range from roughly $18 million awarded to NVR CEO Eugene Bredow to $218 million awarded to Alphabet CEO Sundar Pichai.

According to a recent Stanford study of mega grants published last month, the grants were more common in the '90s but eventually lost favor with investors and proxy advisory firms. The grants again attracted attention in 2018 when the Tesla board awarded Elon Musk a mega grant valued at up to $56 billion with a 10-year duration.

The Musk award prompted a slew of "copycats" granted in the subsequent years, the article states, and some CEOs and boards considered whether such an incentive might apply at their companies. The Stanford authors, David Larcker and Brian Tayan, analyzed 52 mega grants awarded between 2016 and 2022 at 48 different companies and found that the grants ranged in size from $12.1 million in 2020 to Musk's grant in 2018 of $2.3 billion. The median term of the grants in the study was five years.

It's difficult to tell from public disclosures why various boards determined to grant the awards, said Larcker. The descriptions from companies are often "very tidy but not that informative," he added.

"It could be the case that you have a highly valued employee, maybe a founder or visionary leader, and you want to really lock them onto the company," he said. "The numbers are gigantic, so I think that's a pretty good signal from the board to the CEO and maybe a few people in the C-suite conveying that, 'We like our strategy, and these are the people who developed it.'"

Still, there are potential downsides, he said. The payouts are often accompanied by difficult performance targets that could motivate an executive to take on too much risk. "You want to be careful you're not motivating people to do things that are not economically in the best interests of shareholders," he said.

Agenda asked readers about mega grants in its Directors' and Officers' Outlook: Q3 2023 survey, and most respondents, 73.1%, said they don't think a mega grant would motivate their CEO more than a long-term performance share award. Some 15.4% of respondents said such an award could be more motivating than traditional performance awards, while 11.5% reported being unsure.

One respondent wrote that "incentives need to be truly aligned with owners…so a large grant covering a number of years makes sense, but it is to be structured at appropriate levels, i.e. vests at higher prices so owners first get their return."

Yet the Stanford analysis found that, among the 52 mega grants awarded from 2016 to 2022, about 25% had no performance triggers and vested based solely on time. Another 44% of the awards had a single performance trigger, 19% had two triggers, and 12% included more than two triggers, the study found.

Generally, a mega grant has to be risky to the management team, said Dan Ryterband, chairman and CEO of compensation consulting firm FW Cook.

“To make a mega grant sufficiently performance-based to ensure support from reasonable investors, it needs to be so performance sensitive that if anything goes wrong, there is risk it becomes obsolete,” he said.

Accordingly, boards might find themselves with a CEO who is sitting on an underwater grant that has become a demotivator. It could then increase attrition risk and create pressure to revise the terms or make new awards, he said.

However, renegotiating the grants puts the board and company in a difficult position with investors, placing a significant governance risk on top of already destabilizing performance and talent retention risks, he said. Boards should clearly think through the risk calculus of crafting the grants, he said.

Yet, if a CEO has raised an interest in a mega grant with the board, there is also risk in not going forward with one. Ryterband noted that the idea of a mega grant almost always originates with someone in management.

“While most boards would prefer to avoid mega grants because of the obvious say-on-pay risks, that doesn’t mean such awards serve no purpose,” said Ryterband. But, he added, “in most cases, mega grants aren’t necessary and don’t always turn out to be more valuable.”

The same objectives can be adequately supported through the ordinary course of the annual grant process, he said.

Still, the risk of losing an executive because the board didn’t award the compensation the executive sought could also wind up being expensive and a risk for shareholders.

A survey conducted by NFP found that 83% of executive-benefits decision makers at companies don’t think their companies can afford to lose their top executives. The Stanford analysis found that most of the awards are given to key C-suite leaders. The median tenure at the time of the grant was 9.1 years in the role, and 38% of the executives who received mega grants were company founders.

In addition to locking in a founder, mega grants can be an appropriate tool for motivating execs to carry out a turnaround situation where a company has nowhere to go but up, or if a company has potentially unlocked value and the board wants the executive to work aggressively to hit difficult targets and then be well rewarded, said Larcker.

“If you give somebody a gigantic payout with really extreme performance targets to make these things work, you’re putting tremendous incentive on the person,” he said.