

***TOTAL REWARDS  
IN CLOSELY-HELD COMPANIES***

# Total Rewards (Compensation & Benefits)

- Compensation
  - Salary
  - Bonus / incentive (short-term and long-term)
  - Equity
- Benefits
  - Health care
  - Life insurance
  - Deferred payment of salary, bonus, equity earnings
  - Retirement plans (pension, 401(k) plan)

# Closely-held companies typically face important total rewards issues

- attracting,
- retaining,
- motivating, and
- retiring non-family, non-owner executives



# Alignment of total rewards with the business strategy

- results in an intense focus on business goals and encourages executives to accomplish the company's goals to the satisfaction of the company's owners and investors.



Let's discuss compensation

# Any compensation plan should

- Encourage executives to continue their careers with the company,
- Link rewards to financial accountability and the results of the company,
- Apply realistic rewards to good performance,
- Foster team spirit among program participants, and
- Support active participation of executives in development and implementation of the business plan.

# Many of the methods used within large, publicly-traded companies can also be used by closely-held organizations

- Salary,
- Bonus (also referred to as short-term incentive compensation), and
- Long-term compensation.



Identical standards apply within closely-held companies as are routinely used in larger publicly-traded companies

- Nature, scope, and extent of the work involved,
- Size and complexity of the business enterprise,
- Economic and market conditions of the industry,
- Comparable industry compensation,
- Compensation of other executives within the organization, and
- Executives' compensation history.

# Management Compensation Benchmarking

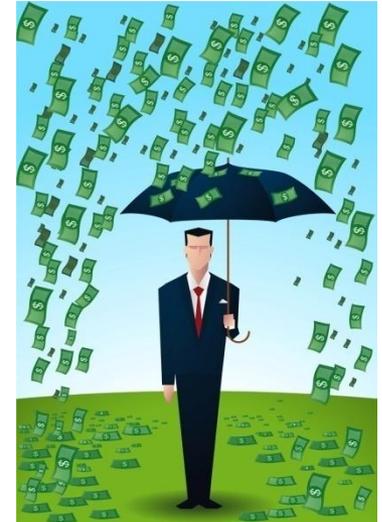
- Step 1: Develop total rewards philosophy
- Step 2: In-depth analysis of the positions
- Step 3: Identification of truly comparable companies
- Step 4: Search for relevant survey data
- Step 5: Matching of positions with comparable companies and survey data
- Step 6: Assess whether compensation mix and amount is within range
- Step 7: Develop a strategy to realign compensation
- Step 8: Build consensus on compensation program
- Step 9: Thoroughly document the concept
- Step 10: Communicate program and implement

# Executive Compensation Components

- Base Salary

- Framework

- Fixed by contract, typically at annual rate
- May be adjusted, in lieu of
  - Deferral
  - Long-term compensation
  - Benefits and perquisites
- May be increased, from time to time, based upon
  - Individual performance
  - Business unit performance
  - Enterprise performance
  - Market conditions



# Executive Compensation Components

- Bonus or Short-Term Incentive Compensation
  - Framework
    - Variable
    - Typically awarded following year of measurement, but other intervals may be utilized
    - Governed by
      - Contract
      - Discretion of company
    - Awards may be based upon one or more of
      - Individual, business unit, or enterprise performance
      - Market conditions



# Executive Compensation Components

- Long-Term compensation
  - Framework
    - Variable
    - Period of measurement may be one or more years, but other intervals may be used
    - Periods
      - May be rolling
      - May overlap
    - Governed by
      - Contract
      - Discretion of company



# Executive Compensation Components

- Awards may be based upon one or more of
  - Individual, business unit, or enterprise performance
  - Market conditions
- Common vehicles, used singly or in combination
  - Stock options
  - Restricted stock
  - Performance shares or units
  - Phantom stock
  - Stock appreciation rights
  - Founder's stock

# What Creates the Wins for the Executive and the Company

## *Tax Efficiency*

- Tax-Deferred Growth Potential for Executives
  - Structure of compensation may provide executive greater flexibility in timing of income recognition
    - Stock Appreciation Rights – Time of Exercise
    - Stock Options – Time of Exercise
    - Restricted Stock – Time of Vest or Time of Grant
      - 83(b) Election
    - Deferred Compensation Plan, such as performance shares or units
      - 409A Regulations
    - Phantom Stock – Time of Receipt
    - Founder's Stock

# What Creates the Wins for the Executive and the Company

## *Equity-like Participation Without Share Dilution*

- Incentives can take on the appearance of equity without providing voting or dividend rights
  - Stock Appreciation Rights – Value of right is based upon change in value of company stock
  - Deferred Compensation Plan – Crediting rate of deferral can be based upon change in value of company stock but are not actual shares or achievement of other targets
  - Phantom Stock – Value is equivalent to company stock without voting or dividend rights

# What Creates the Wins for the Executive and the Company

## *Executive Retention Features*

- A rolling schedule for vesting can provide an executive significant incentive for remaining with a company
  - Example: Use of a three-year rolling vest versus a cliff-vest will both reward the executive but result in the loss of significant benefit value upon departure
- Clawback provisions
  - Some of the incentive structures allow for the claw-back of an exercised benefit if an executive leaves shortly after benefiting from an exercise

Let's discuss benefits

# Employee Benefits

- Protect employees and their families from financial risk
- Increasingly more complex, expensive, and regulated
- Tension between employee and company
  - Employee entitlement
  - Key attraction / retention element
  - Cost increases resulting in reduced offerings and/or higher employee premiums
- Employees expect more choice

# Public Company & Closely-Held Company Benefit Plans

- Health & Welfare Benefits
  - Health Care: medical / dental / vision insurance, Rx
  - Disability income: sick pay, STD, LTD
  - Survivor benefits: term life, AD&D, dependent life
- Retirement Benefits
  - 401(k) plan
  - Profit sharing plan
  - Pension plan
- Paid Time Off
  - Sick days
  - Vacation and holidays
  - Leaves of absence
- Perquisites (Executive Benefits)
  - Add-on
  - Restorative

# Executive Benefits

- “Perks” or Executive Benefits, examples

Add-Ons	Restorative
Club membership	Retirement (SERP)
Financial planning	Disability (LTD)
Company car	Supplemental life insurance

- Advantages
  - Many benefit plan expenses receive favorable tax treatment
  - If tax is deferred, usually not taxed to employee until benefit is received
- Disadvantages
  - Additional costs – especially health care and pension – may not be possible for financially constrained companies

# Integration of Executive Benefits with Core Benefit Programs

- Employee self-service
  - Increased employee responsibility for selection, payment & management of own programs
  - Employees expect access to information
- “Vendor creep”
  - Add-on benefits for executive group may require alternative vendors; integration can be tricky
  - Employee frustration when “one stop shopping” not available
    - E.g., 401(k) vendor provides on-line access to accounts; add-on SERP managed manually in-house



# What Executive Benefits Should Be Offered?

- Decision process same for closely-held vs. publically traded companies
  - Benefits philosophy
    - Competitive vs. market leader vs. market laggard
    - Can differ by program
  - Competitive marketplace for executive benefits
  - Economic conditions of company
- Company desire to attract / retain executives with benefits tools vs. compensation tools (cash, cash incentives, equity)

# Benefits Market Data Benchmarking

- Step 1: Develop total rewards philosophy
- Step 2: Search for relevant survey data – comparable companies & industries
- Step 3: Determine gaps in survey data, company data, and rewards philosophy
- Step 4: Develop strategy to realign programs with market and strategy
- Step 5: Build consensus on total benefits package; align with rewards package
- Step 6: Design / develop / outsource / benefit plan design
- Step 7: Determine administrative processes and costs. Outsourcing costs typically significant; compliance is critical
- Step 8: Thoroughly document concepts; ensure legally compliant
- Step 9: Communicate programs and implement

# Executive Benefits Considerations

## Non-Qualified Plans

- Non-statutory plan; does not meet IRS code (Section 401) requirements for favorable tax treatment of pension, profit sharing and stock bonus plans
- Supplemental Executive Retirement Plans (SERPs) are non-qualified plans
- Flexibility in design / eligibility decisions
- Public companies required to disclose full details

# What Creates the Wins for the Executive and the Company

- Additional benefits to attract / retain needed talent
  - Current top talent
  - Needed talent
    - Mid-career hires
    - Young upstarts
    - Recognize diversity of needs – and lifestyle / family differences
- Examples:
  - SERP restoration plan: restores pension and/or 401(k) benefits reduced for highly compensated executives that exceed IRS salary limitations, or are treated differently due to non-discrimination rules
  - Deferral program: salary, incentive, equity
  - Supplemental group life insurance plan
  - Enhanced LTD benefit

# What Creates the Wins for the Executive and the Company

## *Executive Wins*

- Gains additional benefits lost from IRS limitations
- Gains benefit needed or wanted

## *Company Wins*

- Increased competitiveness in marketplace
- Enhanced ability to attract / retain top executives
- Non-qualified plans permit customization to executive needs
- Typically, company tax deduction when benefit becomes taxable to employee

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