

*The "Learn & Earn" Series™*

November 4, 2010

**"Mr. Owner, Can I Have Equity Too?"**



THE VISIONLINK  
ADVISORY GROUP

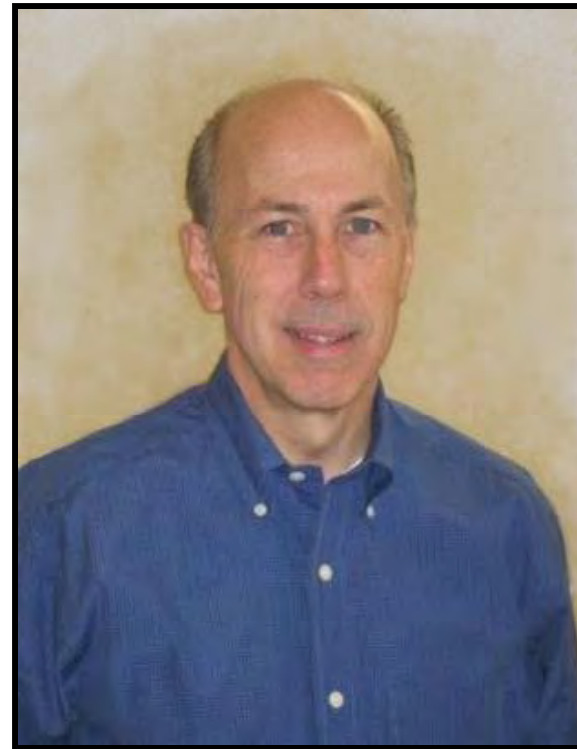
Today's Presenter:

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# Course Credit

Per State Requirements:

To receive CPE credit for today's course, you must respond to at least 75% of the monitoring events – given in the form of polls.

Each person taking the course must respond to the monitoring events from their own computer. You may not share a computer when taking the course

We're happy to provide a copy of today's slides, course syllabus/summary, and a CD of the presentation. Information will be provided at the close of the presentation about requesting these.

**For questions during today's presentation:**

Use the question panel  
To the right of your screen

# Course Objectives

- Understand the “real” issues underlying a decision about whether or not to share stock
- Understand the role of any incentive, including stock
- Understand when stock is appropriate to offer as a growth incentive
- Understand what alternatives to stock might be considered

# Key Concepts



- The issue isn't sharing stock or not sharing stock
  - How to focus employees on what's most important to company growth?
  - How to get employees to think like owners?
  - What are the best ways to link desired results to an incentive plan?
- How will we know when our compensation plans are producing a positive return for shareholders?
- How will we know when there is alignment between our business and compensation strategies?

# What We Say

## Employee

“Mr. Owner, can I have equity too?”

## Owner

“If I share equity, will I enhance my share value or diminish it?”



# What We Mean

## Real Employee Issue

“If I help create value, can I participate in that value?”

## Real Owner Issue

“How do I get my key people to think like me and focused on what’s really important?”

# Employee Focus

Three key areas of financial focus....



# Owner Focus

- Desires ownership mentality where employees are focused on “what’s important”

CEO Worry List

# What's important?



- Fulfilling the business plan
- Sustainable growth
- Appropriate return on capital for shareholders

# What's desired of employees?

- Daily behavior that is designed to fulfill the business plan
- Accountable decision making that reflects awareness of their impact on plan
- Dedicated and committed effort

# Poll #1



# **So, What Does this Have to Do with Giving Equity or Not?**

**Stock is an Incentive**



# Purposes of a good incentive plan

- Create a unified financial vision for growing the business
- Communicate the outcomes and results most valued by the organization
- Create flexible means of rewarding high performers and recognizing special circumstances and achievements
- Improve shareholder value

# How? By making sure incentives...

- Create a sense of partnership
- Provide clarity about vision and strategy
- Increase engagement and commitment—ownership mentality
- Improve execution and productivity

# Incentive Plan Decision

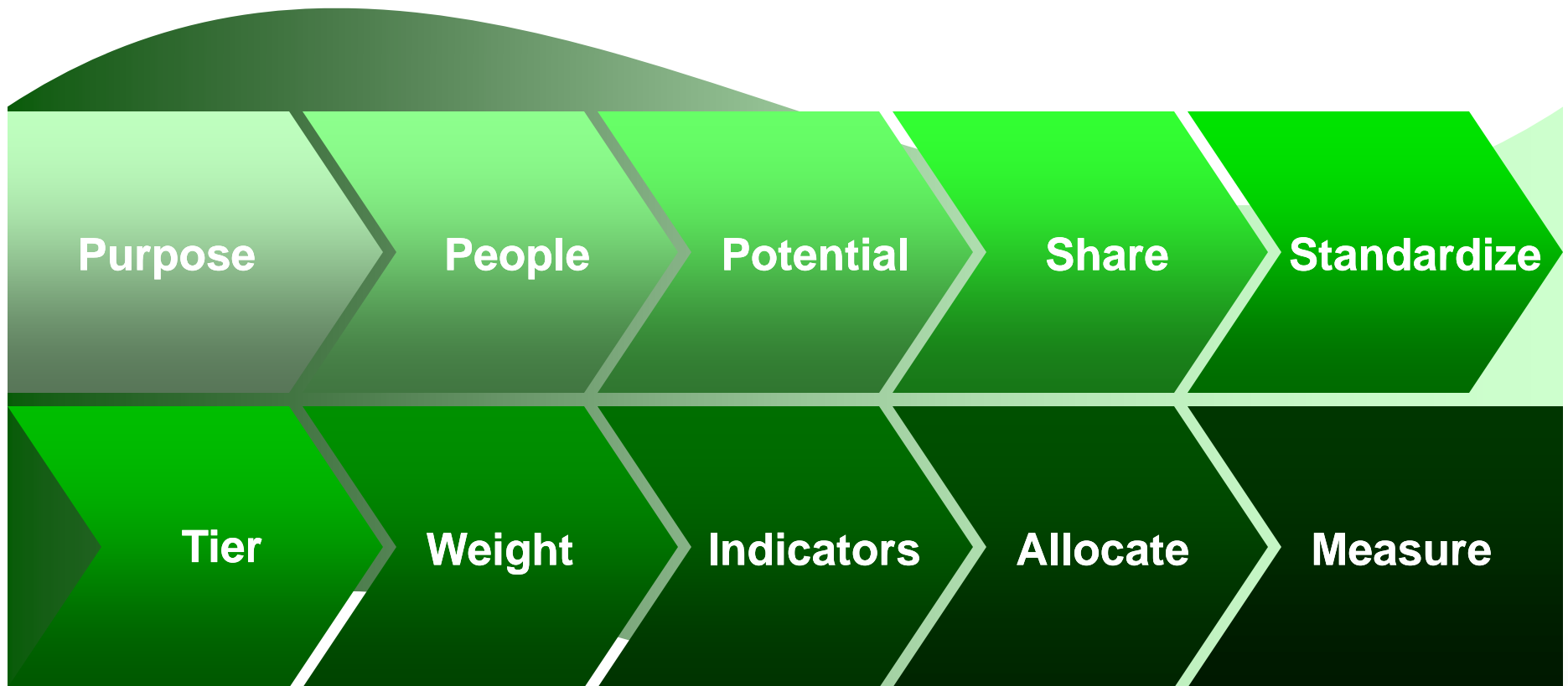
What am I Looking For?

- Sales Incentive
- Performance Incentive
- Growth Incentive

Stock is a growth incentive

# Building an Incentive Plan

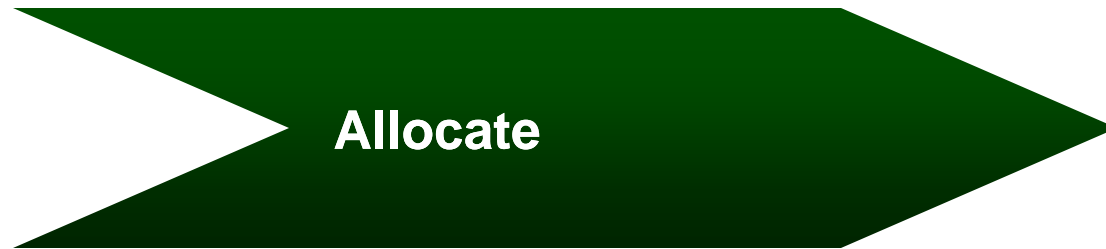
A Unique Process





How and when will the rewards be made available to the participants?





Determine if the awards, once earned, will be paid at the end of the quarter, end of the year or at a future date.

Typically a percentage will be paid annually, and a percentage will be paid in the future.

# For Example

<u>Tier</u>	<u>Short-Term</u>	<u>Long-Term</u>
1	50%	50%
2	70%	30%

## Measure

How will the long-term portion of the incentive be measured over time?



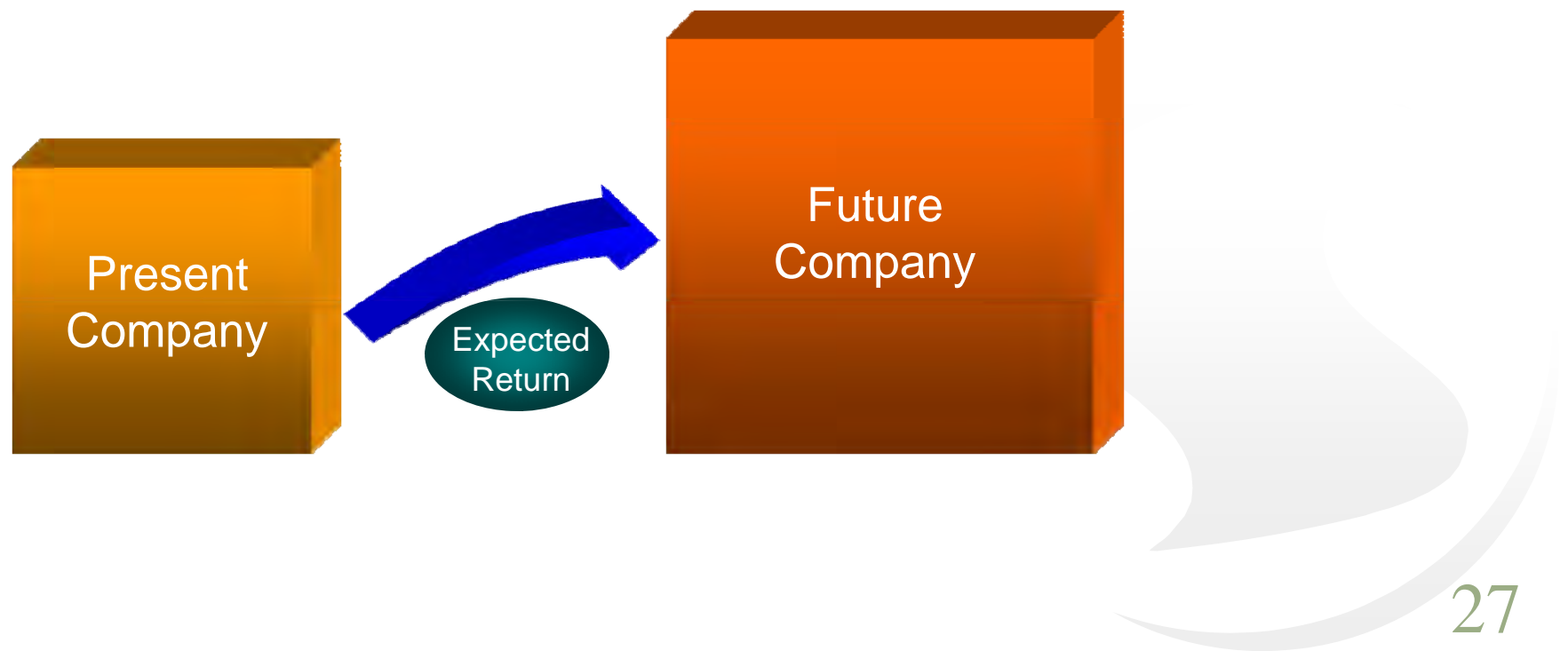
## Measure

Establish the form of the long-term benefit by determining if it should be

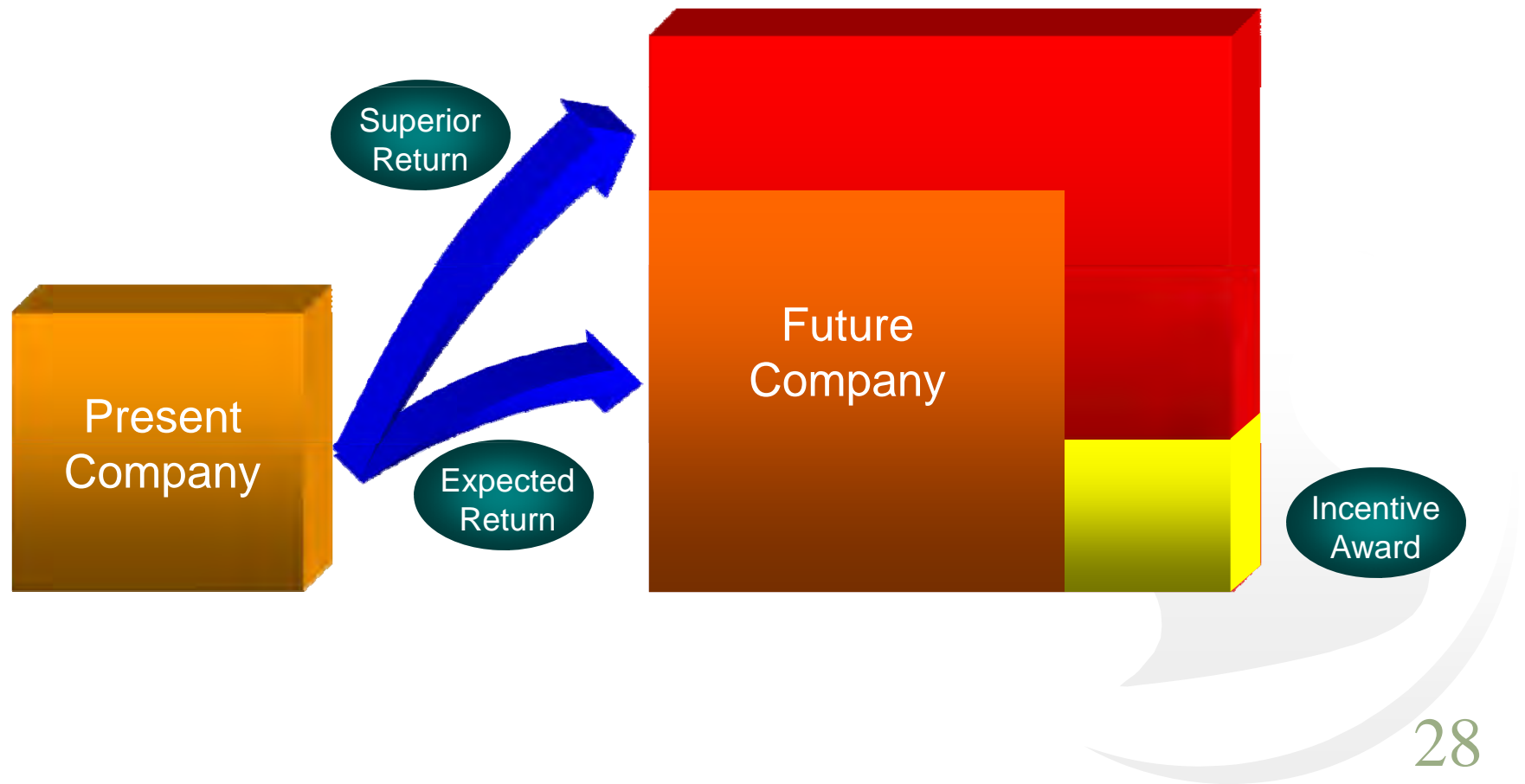
- a) held in a pool
- b) credited with interest or investment earnings
- c) treated as a stock or phantom stock incentive

# **Role of a Long-Term Incentive Plan**

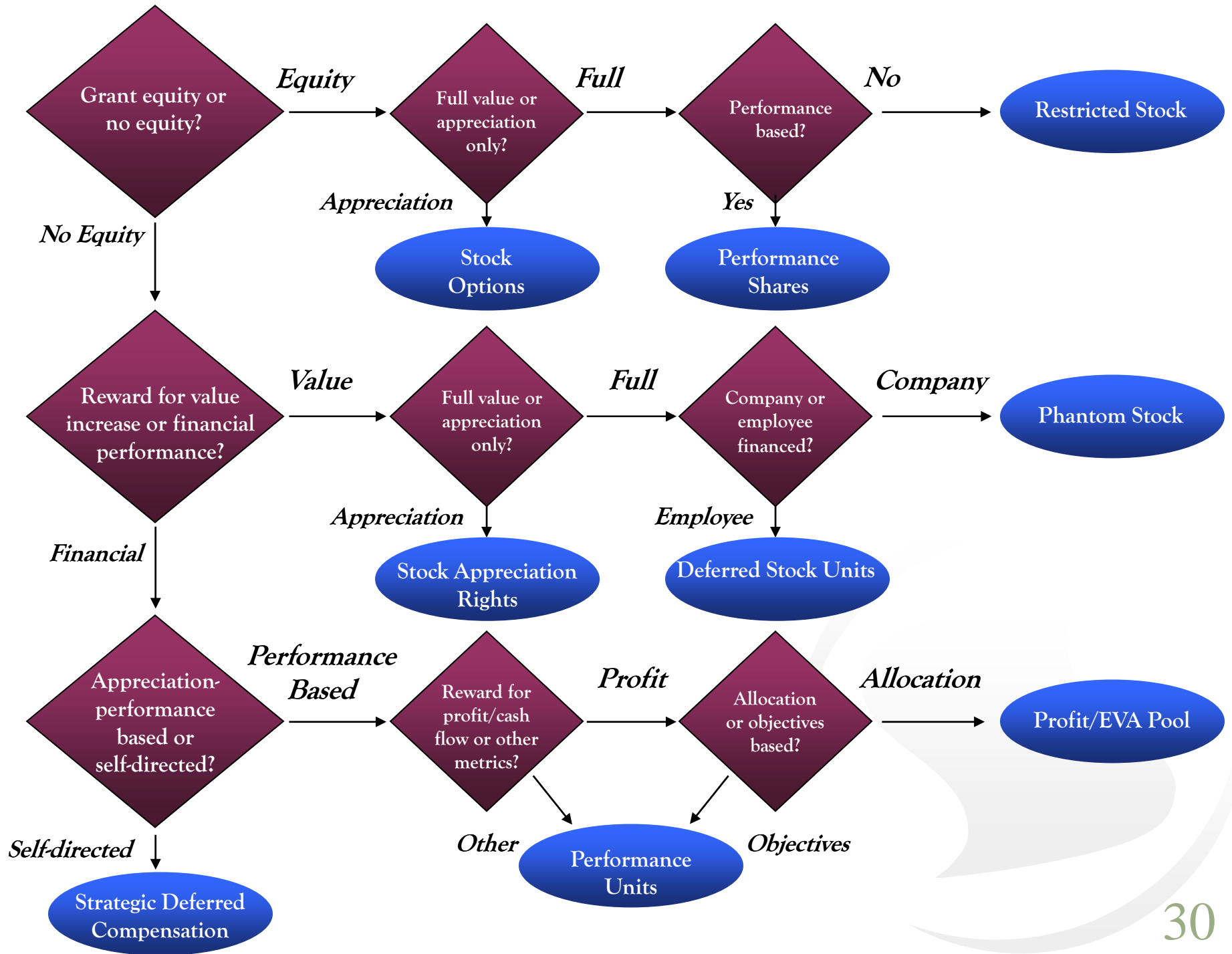
# Creating value added results

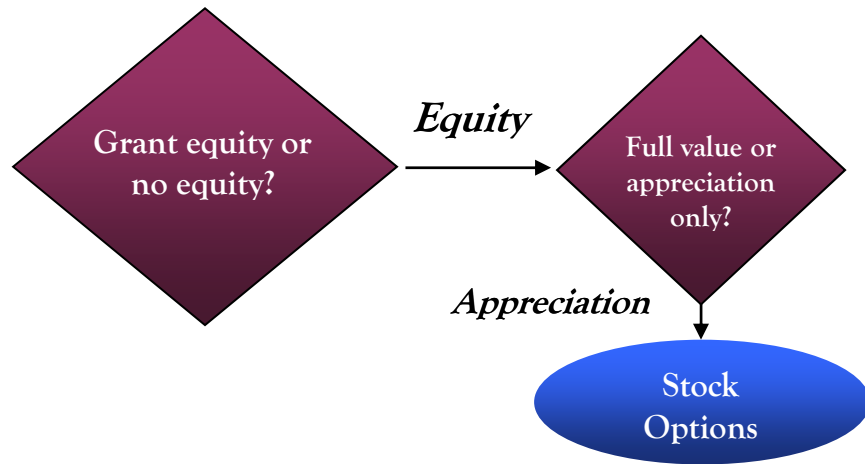


# Creating value added results



# **Long-Term Incentive Plan Decision Tree**





# Stock Options

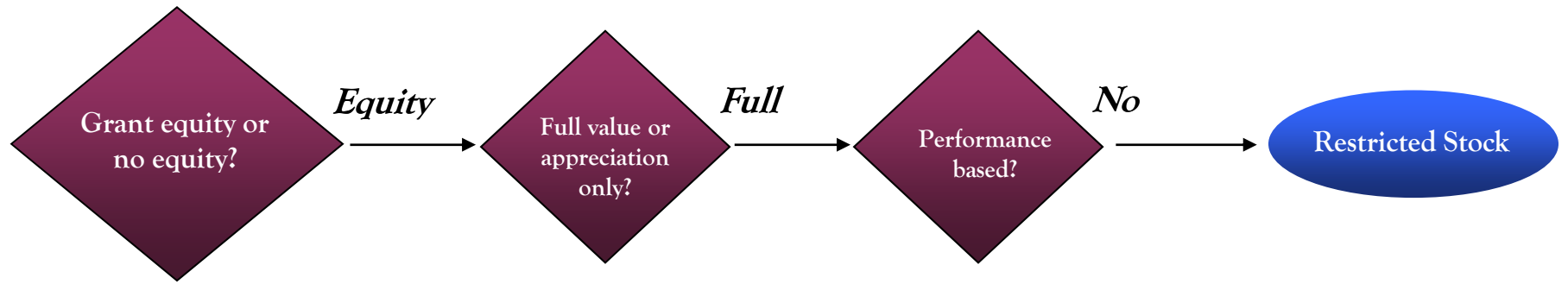


- Employees given a right to purchase stock at a pre-set price
- The right is subject to a time limit and a vesting schedule
- Common in public companies
- Newest accounting rules (FAS 123R) have reduced use somewhat



# Appropriateness— Stock Options

- Do you have employees whom you feel are ready to acquire ownership in the company?
- Have you reached the point where sharing ownership is needed to attract or retain vital contributors?
- Do you feel these employees should participate in future growth but not in present value?
- Will the employees be in a position to fund the purchase?
- Are there means for transferring and repurchasing stock?



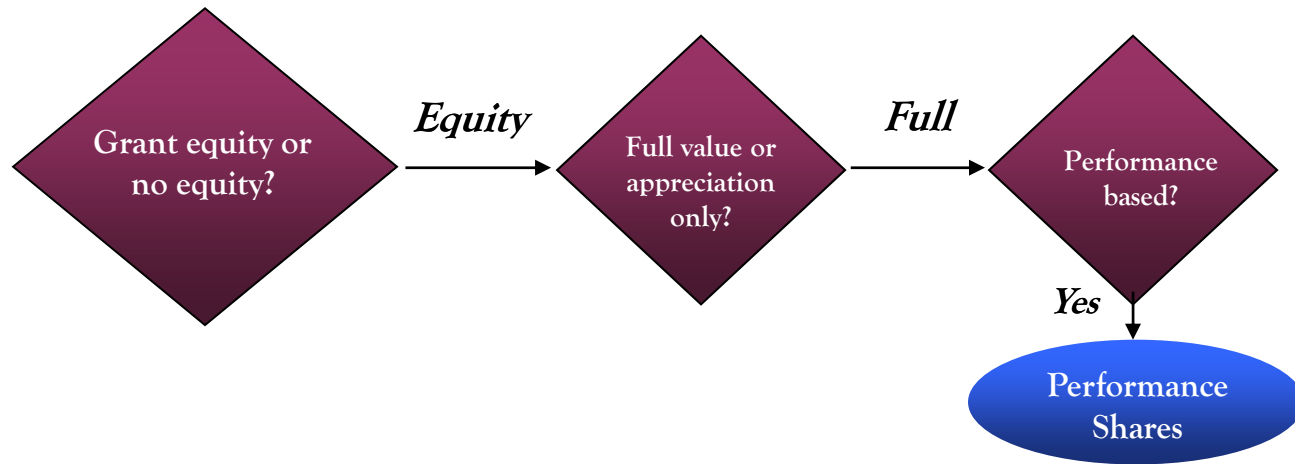
# Restricted Shares



- Employees given actual stock at current value
- Their ability to sell the stock is limited by vesting schedule and market restrictions
- Rewards for past contributions and future growth
- Employees choose to pay tax (ordinary) in year of receipt or when vesting occurs (83(b))
- Full deduction for company in year employee takes into income

# Appropriateness— Restricted Shares

- Do you have employees whom you feel have earned the right to ownership in the company?
- Have you reached the point where sharing ownership is needed to attract or retain vital contributors?
- Are you prepared for the immediate dilution of your equity?
- Are there means for transferring and repurchasing stock?



# Performance Shares



- Employees given the promise to receive stock upon fulfillment of financial goals
- Shares will be “restricted” once received
- Dilution is “self-financing”
- “Sweat equity” converted to actual equity

# Appropriateness— Performance Shares

- Do you have employees whom you feel are ready for ownership in the company?
- Have you reached the point where sharing ownership is needed to attract or retain vital contributors?
- Do you feel these employees should earn that ownership by the fulfillment of important achievable goals?
- Are there means for transferring and repurchasing stock?

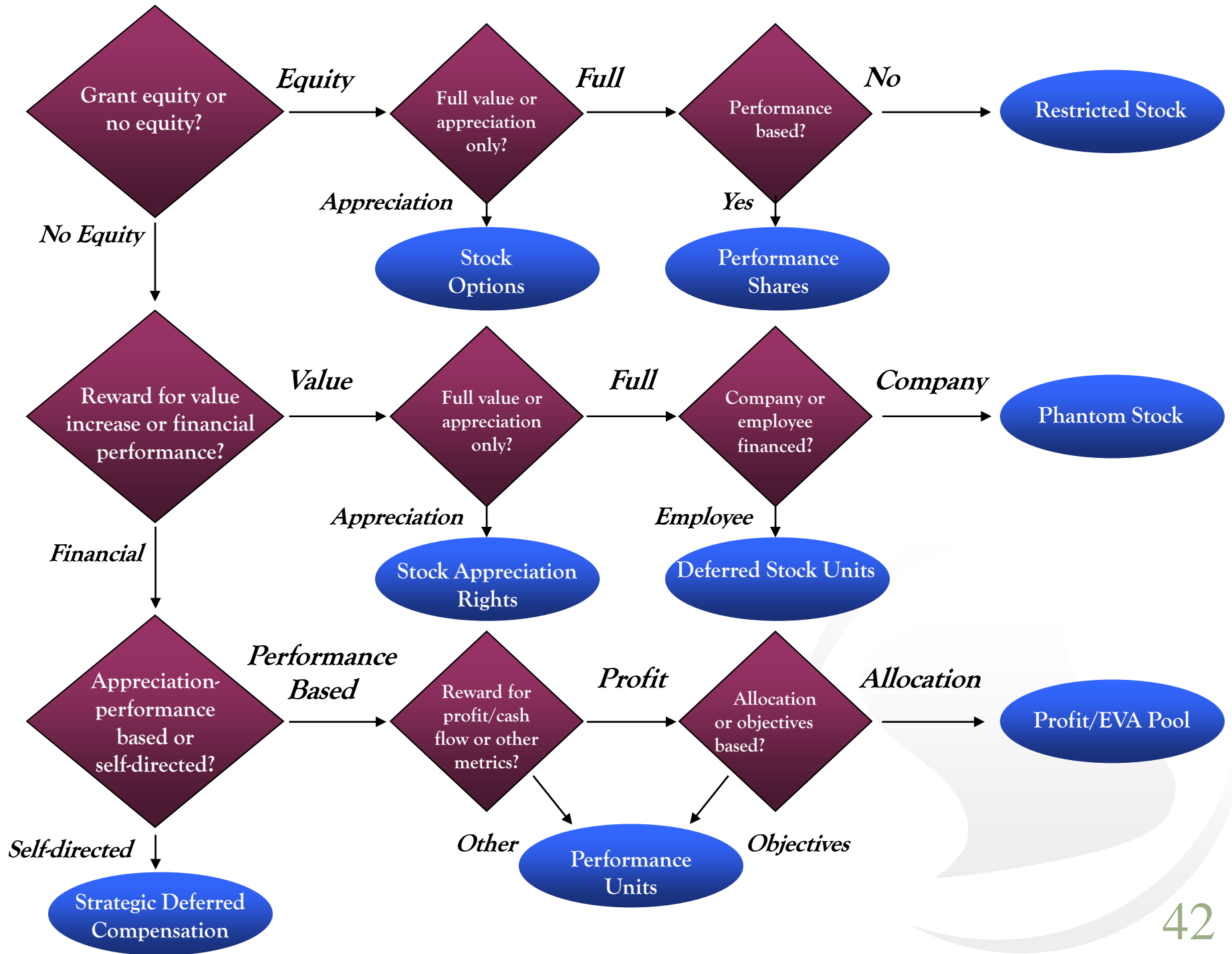
# Variation—Restricted Stock Units

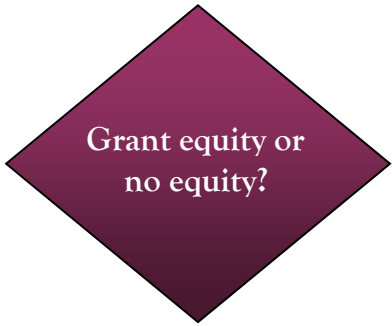
- A grant (unit) valued in terms of company stock, but stock not granted at time of issue
- Upon vesting, company issues shares or cash, based on value of stock
- Plans differ in allowing participants to decide how they want to settle after vesting
- Creates flexibility
- Becoming more common in public companies



# Poll #2

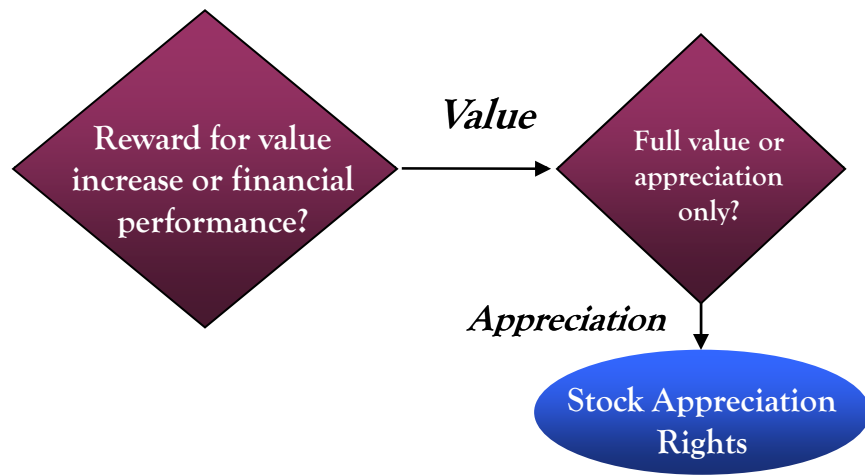






*No Equity*



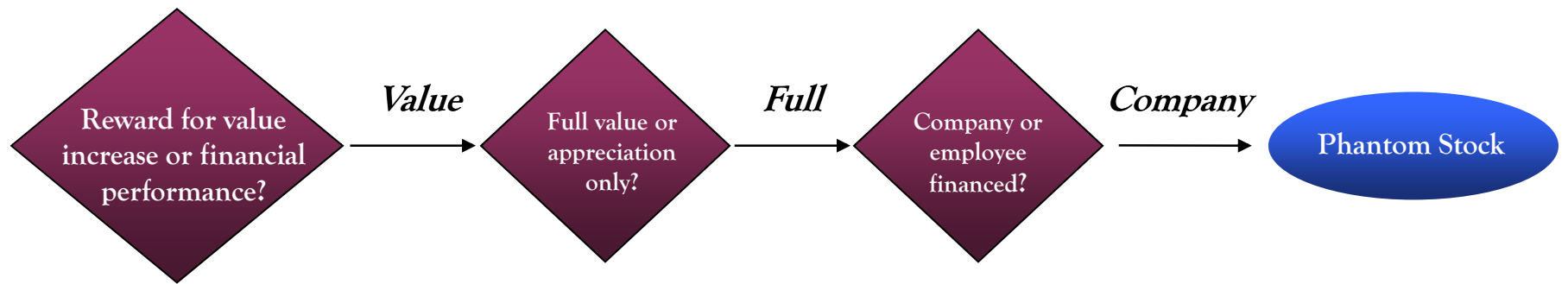


# Stock Appreciation Rights (SAR)

- Employees given a promise of cash payment at a future date
- The value will be based on the appreciation in stock price from the date of award to the date of redemption
- Like a stock option but without the need to pay for shares
- Value will be taxed as ordinary income when received
- Employee not given full control over date of redemption

# Appropriateness— Stock Appreciation Rights

- Do you have employees whom you feel should benefit from future appreciation in the value of the company?
- Do you feel these employees should participate in future growth but not in present value?
- Are these employees in a position to directly influence the value of the company stock?
- Is the company prepared to handle the cash flow responsibilities of the plan?



# Phantom Stock

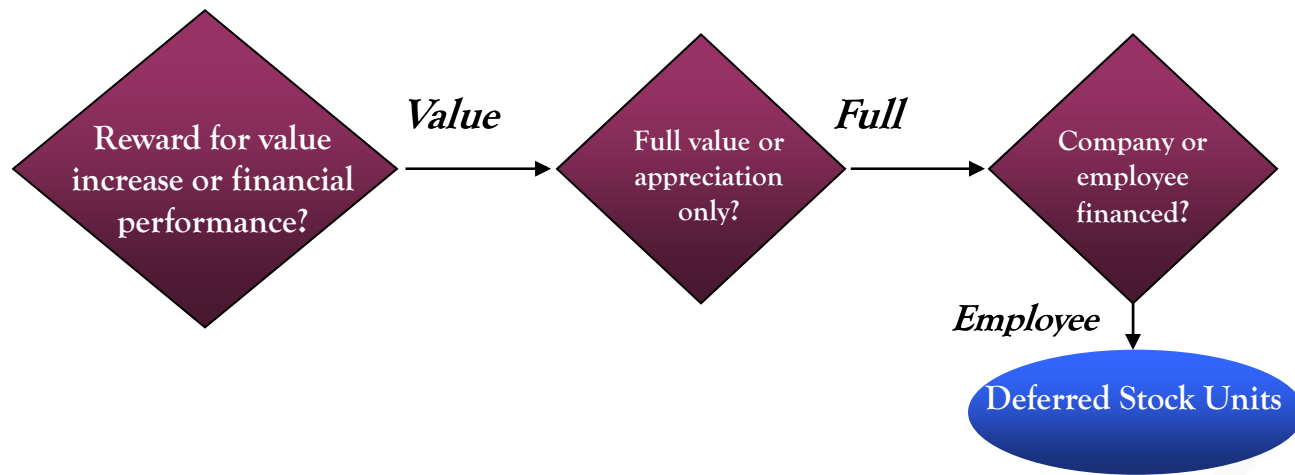


- Employees given an award that has current value essentially equivalent to company stock value (subject to vesting schedule)
- No rights of ownership
- Rewards for past contributions and future growth
- Payments will be made in cash at pre-determined dates
- Full deduction for company in year employee takes into income



# Appropriateness— Phantom Stock

- Do you have employees whom you feel should be compensated for past as well as future performance?
- Are you prepared to reduce the immediate value of the company (albeit without dilution)?
- Are these employees in a position to directly influence the value of the company stock?
- Is the company prepared to handle the cash flow responsibilities of the plan?



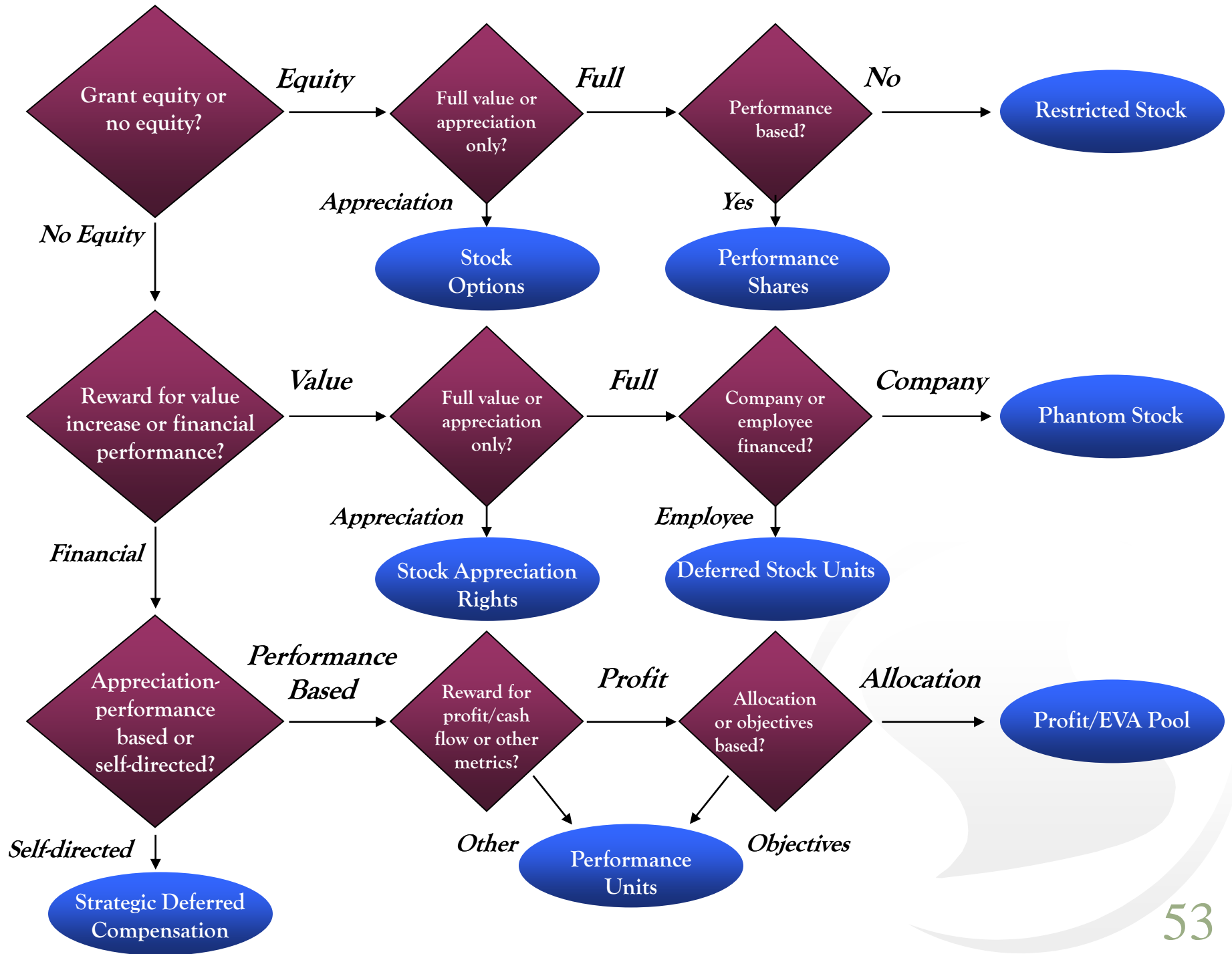
# Deferred Stock Units

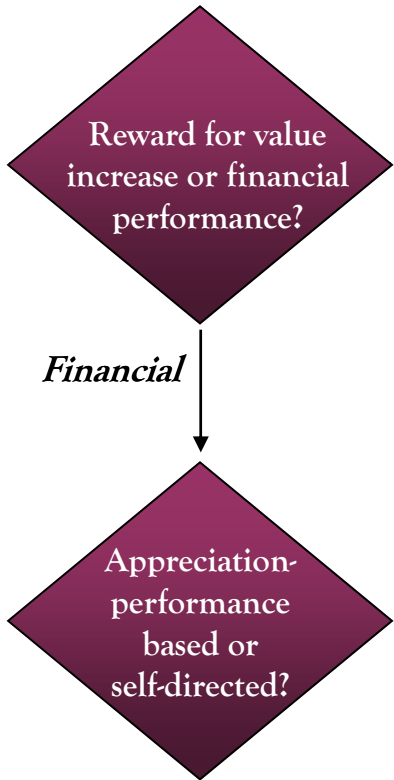


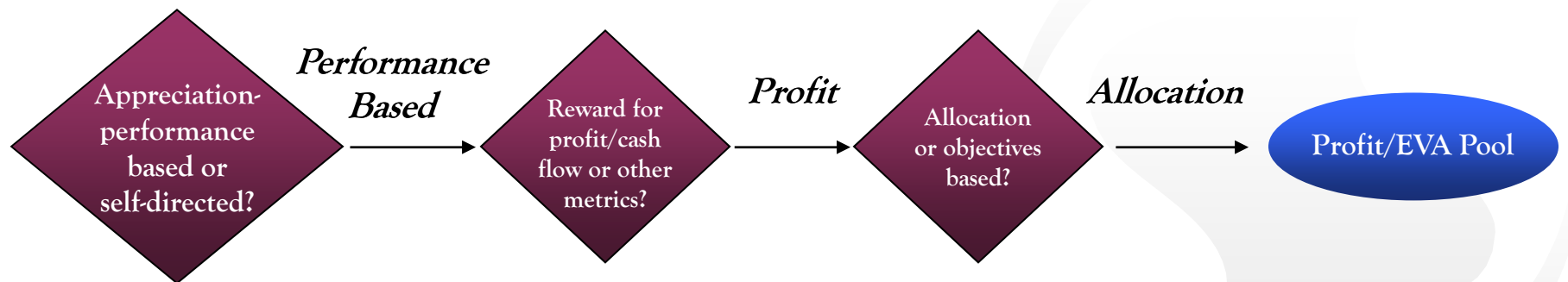
- Employees given an opportunity to purchase phantom shares on a pre-tax basis
- Similar to a deferred compensation plans, but account value is measured by hypothetical stock price
- No rights of ownership
- A “pay-to-play” approach
- Payments will be made in cash at pre-determined dates
- Full deduction for company in year employee takes into income

# Appropriateness— Deferred Stock Units

- Do you have employees whom you feel should be given an opportunity to participate in meaningful upside potential in company value?
- Do you feel the employees should make a financial commitment to the plan?
- Are these employees in a position to directly influence the value of the company stock?
- Is the company prepared to handle the cash flow responsibilities of the plan?







# Profit (or EVA) Pool



- Employees given a right to participate in an annual distribution from an accumulating profit pool
- A percentage of profits are credited to a pool that is to be distributed to selected participants in future years
- Selected percentage of the pool allocated to participants
- Typical distributions may begin in year 3 and recur annually
- EVA concept calls for a reduction from the annual credit for an amount earned by capital contribution

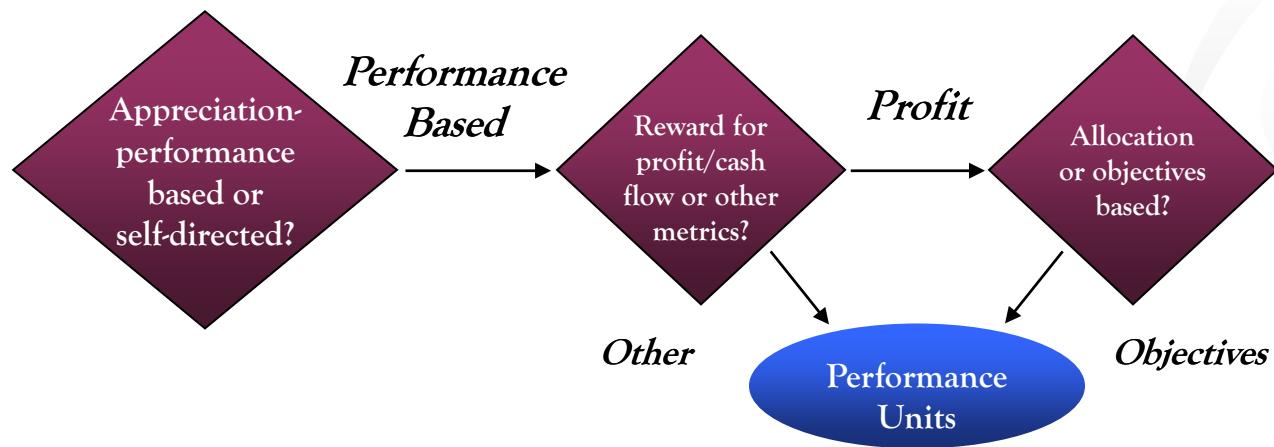


# Appropriateness— Profit (or EVA) Pool

- Do you have employees whom you wish to reward with participation in company profits?
- Are you prepared to share information about profits with participants?
- Are these employees in a position to directly influence company profits?
- Is the company prepared to handle the cash flow responsibilities of the plan?

# Poll #3





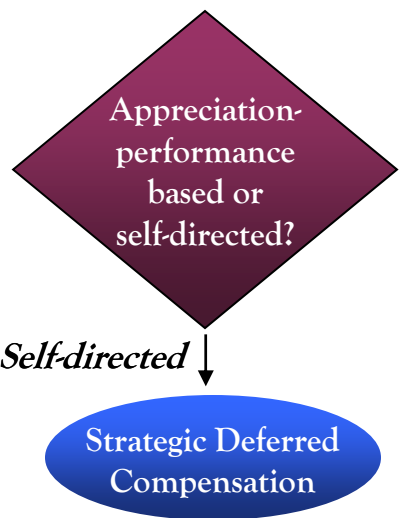
# Performance Unit Plan



- Employees given award units (PUPs) with a current value (e.g., \$100) that will be redeemable in a few years (3 years most common)
- Payment is made in cash at the end of the period
- The value of the PUP at redemption will depend on 2 (or 3) performance metrics
- Value of the PUP may be much higher than starting amount, or much lower (even \$0)
- New PUP cycle starts each year, thus ultimately producing an annual payout

# Appropriateness— Performance Unit Plan

- Do you have employees whom you wish to reward with long-term payments based on financial factors other than stock appreciation or profits?
- Can you identify at least 2 financial metrics that are important measurements of success?
- Are these employees in a position to directly influence those metrics?
- Is the company prepared to handle the cash flow responsibilities of the plan?



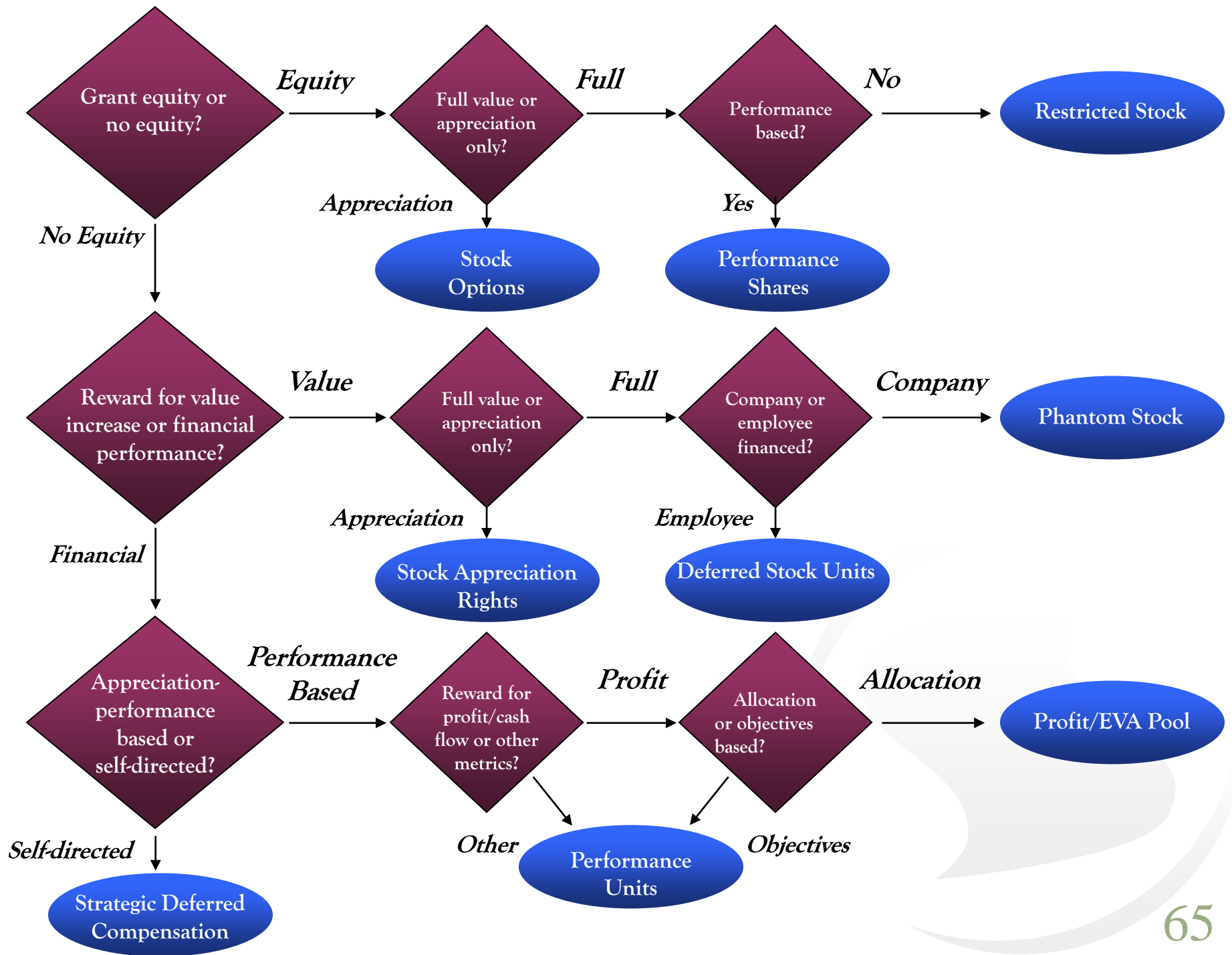
# Strategic Deferred Compensation

- Employees awarded a credit to a retirement account
- The amount credited typically varies depending on pre-set company performance achievements (e.g., revenue and/or profit goals)
- The account is “self-directed” so that employee may choose between alternative investment options
- Vested account paid in cash upon termination or retirement
- Employee may add voluntary deferrals

# Appropriateness— Strategic Deferred Compensation

- Do you have employees whom you wish to reward with deposits to an accumulation account?
- Can you identify 1 or 2 key financial results that would warrant deposits for the participants?
- Once the deposit is determined would you like the simplicity of the employees self-directing the performance options?
- Is the company prepared to handle the cash flow responsibilities of the plan?





# Steps



1. Determine eligible group (allow for future participants)
2. Build a financial growth model
3. Assess new value being created for shareholders
4. Determine the percentage or amount of the future value (or increase in value) to be shared
5. Select a grant schedule (one time or annual) and begin illustrating the grants

# Steps



6. Test the model for Base, Target and Superior standards
7. Assess the value of the awards against “rules-of-thumb” (see next slide)
8. Determine vesting schedule
9. Make some turnover assumptions
10. Test cash flow (and determine if pre-funding is appropriate)
11. Document and launch

# LTIP “rules of thumb”

- Make the present value of your LTIP the same as the value of your annual incentive plan
- Express value as a percentage of salary
- Range from 20% to 100% (depending on company size and value of each position)

# Next CPE Course:

## **“The Eight Fatal Compensation Mistakes”**

To be held on:  
Wednesday, December 1, 2010

# Next Online Seminar:

## **“Creating an Ownership Mentality without Giving Away Equity”**

To be held on:  
Tuesday, December 7, 2010

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# Questions?



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# Thank You!



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