

What is a “Competitive” Equity Grant?

Thoughts from Jo-Dee Gentile, Principal

In my consulting experience, one of the most challenging client assignments is developing “competitive” annual and new hire stock option grant matrices.

There are three aspects of total compensation that we usually examine when developing competitive compensation for any organization: base salary, short-term incentive (or bonus) and long-term incentive (usually equity). Obtaining representative and accurate market information for each aspect presents some challenge. The level of that challenge has an ascending scale. Determining competitive base salary is pretty straight forward: designate a peer group, or preferred salary survey data cut, and use a particular percentile, say the 60th, as an anchor.

Determining competitive short-term incentive targets gets a bit more complex. Here we introduce the concepts of “target amount vs. amount actually paid” and “with or without employees who get zero” to the market percentile.

When we determine “competitive equity compensation,” the complexities grow geometrically. The client may want to target, say, the market 50th percentile of a peer group of twenty companies. So, does that mean the 50th percentile calculated present value of the grant? Does that mean the 50th percentile of the actual number of shares delivered? What about the 50th percentile of the peer group’s overall annual distribution, or “burn rate?” Does that mean the size of the grant as a percentage of the company’s total shares outstanding? In this list we haven’t even touched on the concept of total holdings as a percentage of shares outstanding that is a common point of comparison for executives of pre-IPO companies.

One of my clients asked that I model what annual and new hire grant matrices would look like were I to use each of these scenarios. In each case we used the same “competitive target” - the 50th percentile. For each of these models, we used the closing price of the company’s stock on a specified date and the total number of shares outstanding on that same date to “translate” into the company’s stock. Each way of looking at the market date resulted in a different stock option grant. For mid-level managers varied from a low 1,100 to a high of 2,100. Each answer was “competitive,” although quite different.

So what is a competitive grant? It really depends on the answer to the next question: Which grant matrix is sustainable given the company’s business plan, equity pool resources, and staffing plans? It is more than just a number.

The changes in accounting practices and the economic roller-coaster of the last years have added more complexity to this determination. Stock options are not the only vehicle being used – restricted stock and unit plans and being used at all organizational levels. Shareholder and SEC/federal pressures to tie organizational performance to equity awards has brought forward a new set of performance share grants. How the questions around “risk management” will affect the design of equity compensation plans are still to be determined.

