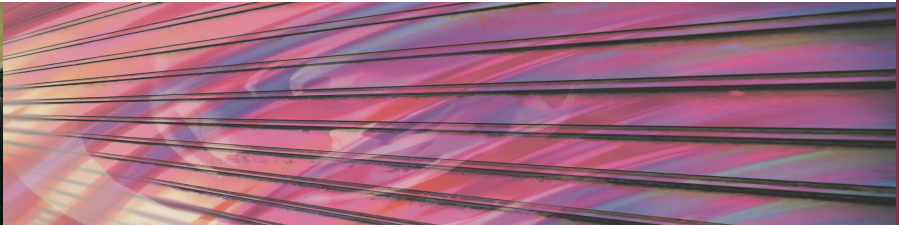


“Stock Incentives for Employees of Private Companies”



Overview

Successful privately held companies build compensation plans that strive to create an “ownership mentality.” To achieve that, they seek to fulfill pay for performance objectives that will accomplish the following: communicate and reinforce the values, goals and objectives of the company; engage employees in the organization’s success; reward contributors for successful achievements. This aim usually leads progressive companies to consider whether or not to offer stock to their key talent. And if not stock, what other vehicle might be used to achieve a similar end.

The Initial Thought Process

In VisionLink’s experience, the following reasons usually drive a company to examine the merits of sharing stock with employees—even in a privately held environment.

1. The company wants to create direct alignment with company goals
2. The business wants to tie rewards to performance (eg the improvement in stock price)
3. Owners/shareholders want to move the focus of their key people to long-term value creation

When Stock Offerings are Usually Considered

Private companies that offer stock usually do so either because of anticipated events or because of targeted areas of focus they are trying engender within the ranks of their key people. A common list of motivations typically includes the following:

- Expecting to “Go Public” – creates the right “currency” for attracting key talent not likely to join without such an offering; stock purchase plans are also common in this instance

- Expecting to “Be Acquired” – options can keep employees in place and motivated; high motivation to improve stock value (to cash in at sale)
- Looking for Succession Plan that Includes Employees – creates stock buyout option; must be integrated into a comprehensive succession planning strategy
- Looking to Retain and Reward Key Employees – mirrors what public companies do when competing in this market for employees; requires ability to handle transactions (for both the company and the employee)
- Looking to Create an Ownership Mentality – ESOP plans commonly used when the company wants this mindset to permeate all employees
- Looking for a Full Exit Strategy – usually incorporates a leveraged ESOP; permits the plan to borrow money to buy out the owner’s shares; requires careful planning – not for everyone

Pros and Cons of Stock Offering in Private Environment

Justification

- Stock offerings can lead to higher productivity (equity dilution is outweighed by increased results)
- Productivity and dilution issues aside, sometimes stock plans are done strictly for recruitment and retention

Potential Negatives

- Transactions have to be anticipated; individuals will own shares that need to be dealt with (sale, redemptions, etc.)
- Since participants in a stock plan are “real owners” they will have “real access” to financial information about the company
- Stock plans require a significant amount of tracking and administration

Alternatives to Stock

Because of some of the potential pitfalls associated with stock plans, private companies should explore alternative plans first such as simulated stock plans or long-term cash awards of various types.

In Conclusion

Stock can be an effective solution in the right instance for a privately held company. However, in going down that road, the business must be very clear about the purposes it hopes to fulfill, about

the potential pitfalls associated with equity arrangements and do so only after exploring other alternatives that might equally or better achieve the overriding objectives.

VisionLink is a national compensation consulting firm focused on helping companies envision, create and sustain compensation strategies that will be key drivers of results and increase the productivity of employees.



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