



Share plans

Using equity to motivate and reward employees

'In addition to the limit on basic pay, Mr Obama said if affected executives receive any further bonuses, they "will come in the form of stock that can't be paid up until taxpayers are paid back for their assistance"'. (Source www.bbc.co.uk)

Remuneration, and in particular executive remuneration, has been under an ever increasing spotlight since the credit crunch first hit in 2007. Increasing emphasis has been placed on longer term incentives for management and "claw-back" where performance conditions are not met.

Whilst share plans are not a complete answer to the concerns currently facing shareholders, they can be part of the solution.

Share plans in any form operate over a period of 3 to 5 years which means staff are tied into the business. The rewards they deliver are linked directly to share price and can be further tailored to ensure that share awards only pay out if the specific company's performance is strong enough.

Whilst it's true that share plans align employees' interests with staff, it's also true that the alignment isn't perfect. Share plans, like share prices, can over-reward in a strong market and under-reward in a recession.

However, communicated correctly they can improve employees' concentration on the financial health of a business, promote a team ethic and improve morale and, in these times when credit is constrained, provide a tax efficient incentive for employees that has little effect on cash flow.

Underwater options

'Google last month announced that it would offer to exchange its employees' stock options for new ones at a lower strike price, recalling the wave of options repricing that took place after the dotcom crash in 2000. Many Silicon Valley companies argue that repricing or exchanging options that are heavily "underwater" is essential if they are to keep staff motivated and discourage poaching by rivals.' (Source www.ft.com)

Listed companies in the UK are being faced with the same issue. Option awards made over the last 3 years have become worthless and, therefore, potentially demotivating for key employees.

What are companies doing in practice? We are not aware of anyone actively re-pricing options or awards. What companies are doing is realising that previous awards are unlikely to vest and are cancelling those awards to free up headroom for new awards going forward.

In addition, following a trend that began in the early 2000s, very few listed plc operate share option plans today. Most use Performance Share Plans (i.e. free shares that vest if certain company specific performance conditions are met).

Performance Share Plans have the advantage of delivering value regardless of market conditions provided the company meets its own performance targets. In addition, when compared with conventional share option plans, PSP reduce shareholder dilution.

If you are faced with underwater options or coming up against dilution limits you need to consider likely shareholder reaction to cancellation of previous awards as well as any subsequent accounting charges that may hit your P&L account.

Information

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