



GRAHALL

845 Third Avenue, 6th Floor
New York, NY 10022

Phone: (646) 290-5129
Fax: (646) 290-5001
Online: www.grahall.com

LONG-TERM INCENTIVES CHAPTER 12 ABSTRACT

LONG-TERM INCENTIVES

One of the major differences between short-term incentives, mid-term incentives and long-term incentives is the length of the performance period and, to a lesser degree, the length of the distribution period or vesting terms. When the length of the performance and distribution/vesting period are added together, the typical long-term incentive program typically covers a 5 to 10-year period. Compare that to short-term incentives, which usually cover up to a year, and mid-term incentives, which usually cover a three to five-year period.

Because the organization's—and executive team's—most challenging responsibility is to position the organization for long-term success. Determining how to relate rewards to organizational and executive performance over an extended period of time is no easy task.

Used correctly, long-term incentives are a very powerful component of the total executive reward strategy designed to accomplish at least some of the following objectives.

- Align executive interest with that of key shareholders.
- Attract and retain executives.
- Promote long-term thinking.
- Share the success of the organization with the executive.
- Provide a platform for wealth accumulation programs.

There are basically three types of long-term incentive vehicles: (a) appreciation-based awards, such as stock options and stock appreciation rights; (b) full-value awards, such as restricted stock with time vesting, and performance shares; and (c) cash-based plans.

With all of these long-term incentive instruments, how do you which ones will work for your executive total reward program? While there is no one size-fits-all answer there are some key general considerations that must be taken into account when designing your plan:

- **Efficiency.** Efficiency favors restricted stock/RSUs and cash if an organization is thinking about financial statement expense.

- **Shareholder Alignment.** Both stock options and restricted stock align executives with shareholders.
- **Retentive Power.** Restricted stock and cash come out the winners.
- **Tax Effectiveness.** Both stock options and SARs are better than restricted stock when it comes to tax effectiveness.
- **Private Company Considerations.** These include voting rights, dividends, and financial reporting and valuation.

While there are plenty of long-term incentive vehicles to choose from, none of them are perfect. And this is why most of the companies we work with are taking a double-pronged approach when it comes to long-term incentives strategy. In most cases, a thoughtful mix of equity compensation as well as performance-based vehicles gets the right message across and accomplishes what long-term incentive plans are supposed to do: attract and retain top execs while also holding them accountable to the organization's long-term success.

A long-term incentive can be one of the most complicated components of a total executive reward strategy. In addition to ensuring that the plan is effective and gels with environmental factors, shareholder issues, and business and people strategies, it also has to meet complex government and tax regulations. Finally, a good balance of vehicles ensures that your long-term incentive plan doesn't speak to just one area of your organization, but allows your organization to accomplish a wide variety of goals.

Long-term incentives that work best are those that are used with mix in mind. Nicely balanced with other components, long-term incentives can send the right message—and can be highly motivating. The goal should be to thoughtfully design your long-term incentives so that you are rewarding executives for making decisions that will serve your organization well and enhance long-term success.