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The Business Case for Milestone-Based Stock Awards

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The following is based on a media interview with Matt Turner, managing director in Pearl Meyer's Chicago office.

Q: How common is this type of award?

A: Milestone-based stock awards are not very common. Most performance share plans are tied to stock price and/or financial measures, such as relative total shareholder return, earnings growth, return on invested capital, and revenue growth.

Q: Why would companies choose to pay executives in this manner?

A: Milestone-based stock awards make sense when a company's strategy involves doing things that have seldom, if ever, been done before. In such cases, achieving key milestones can signal greater likelihood of ultimate strategic success. Acceptable profit and return performance might be possible in the short run by doing things in normal or proven ways, such as expanding margins on existing businesses or increasing revenue on existing products. But placing an emphasis on new business, processes, products, services, or markets is saying that it matters how you get there. For example, cable companies instituted milestone-based stock incentives in the late 1990s as "broadband" services came into being. Signing up broadband customers was paramount to preserve or extend market share in a new and more profitable phase of the industry.

Q: Is it a good move for investor confidence?

A: Such plans can be good for investor confidence *if* investors believe in the strategic premise posed by the company, and *if* the goals are truly meaningful. Investors are naturally skeptical of non-financial goals, so they will be paying very close attention to the nexus between achievement of milestones and long-term financial success.

Q: Does this form of compensation tend to result in considerably greater payouts than would be possible through more a traditional incentive approach?

A; Such plans are not necessarily richer than financial-based performance share awards. It all depends on the quality and stretch nature (relative difficulty) of the established milestones. In hindsight, if a company has achieved its milestones, one must ask if the company is in a more successful strategic position today than it was at the start of the performance cycle. If the answer is yes, and the stock price agrees with this assessment, then one can conclude that the incentive program was aligned with shareholder interests.

About the Author

Matt Turner is the president of executive compensation and leads the executive and broad-based compensation consulting practices at Pearl Meyer. In his role, he oversees a team of senior compensation consultants in the execution of the firm's growth strategy and in the development of consultants at various stages in their careers. He specializes in advising company boards and senior management on executive compensation strategy, incentive plan design, tailoring of performance measures, and the setting of shareholder-focused performance objectives.

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