

How Talent Concerns Are Changing the Use of Equity

A Compensation Committee Series Webinar

Presented by NACD and Pearl Meyer

May 19, 2022

Presenters



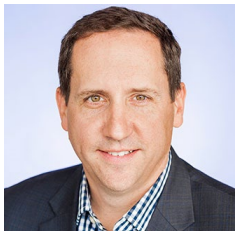
Pamela Arway

Board Member, DaVita Kidney Care, Iron Mountain, and The Hershey Company



Aalap H. Shah

Managing Director, Pearl Meyer



Greg Stoeckel

Managing Director, Pearl Meyer

Housekeeping



- Submit a question and receive your answer directly from the presenters, either during today's webinar or as a follow-up. You will also be opted-in to receive future executive compensation thought leadership from Pearl Meyer.
- Presentation slides are available today at www.pearlmeier.com/talent-concerns-and-equity and within the webinar console.
- The replay will be available early next week at www.nacdonline.org/webinars and www.pearlmeier.com/talent-concerns-and-equity.

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Agenda

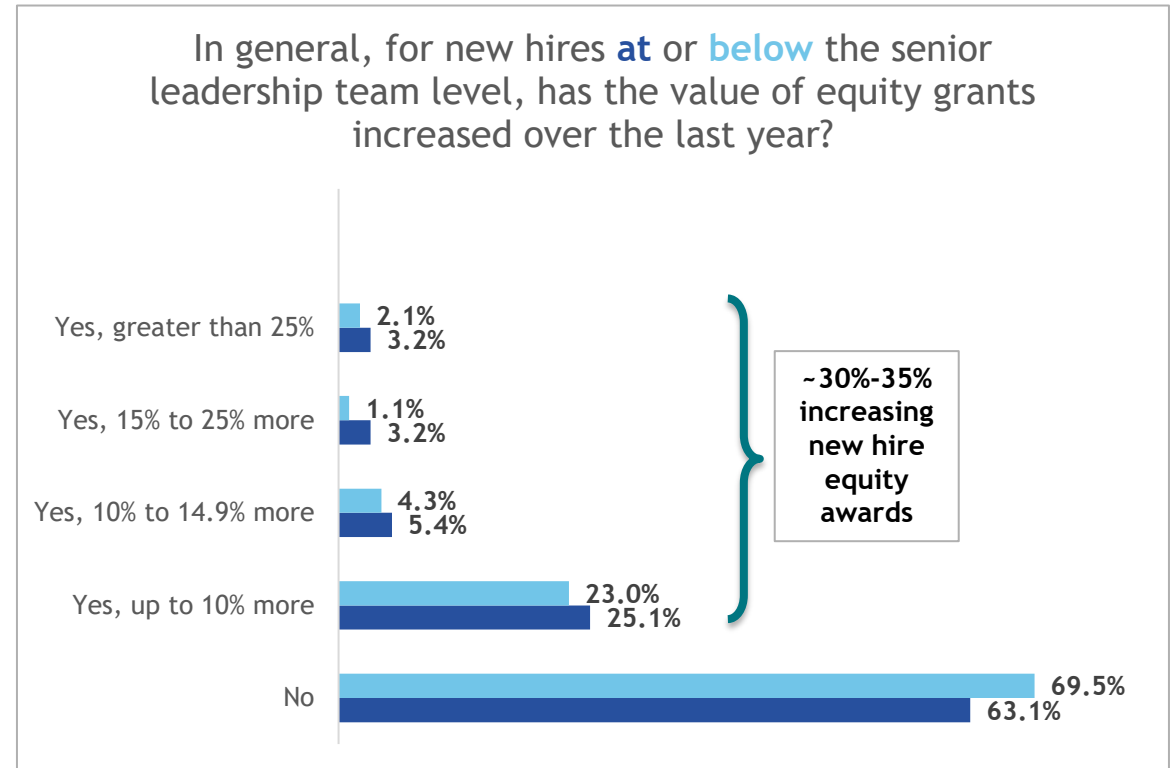
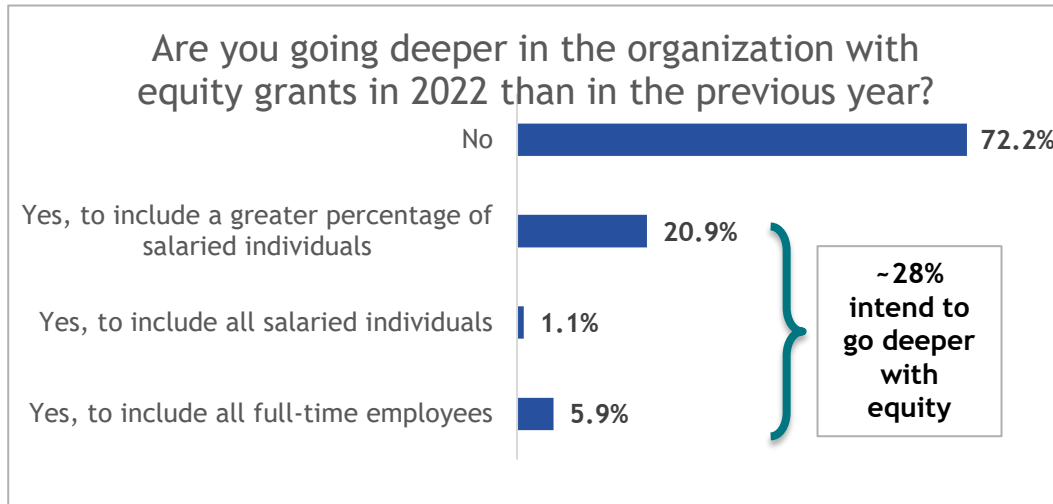


- The ongoing talent shortage is affecting more than just annual salary budgets
- Compensation committees are having to balance the need to attract and retain the right people in the right jobs with the potential long-range consequences that could arise from the expanded use of equity grants today
- Timely new data illustrates potential trends in how equity is used to compensate management—and increasingly roles lower in the organization
- How to evaluate what is happening with equity, how to remain competitive, and avoid future issues
- How to effectively communicate changes in equity strategy to existing employees and shareholders
- How to explain the value of grants to plan participants to ensure maximum effectiveness as a retention vehicle

Equity Use is Expanding

- Companies are beginning to move equity grants deeper within the organization.

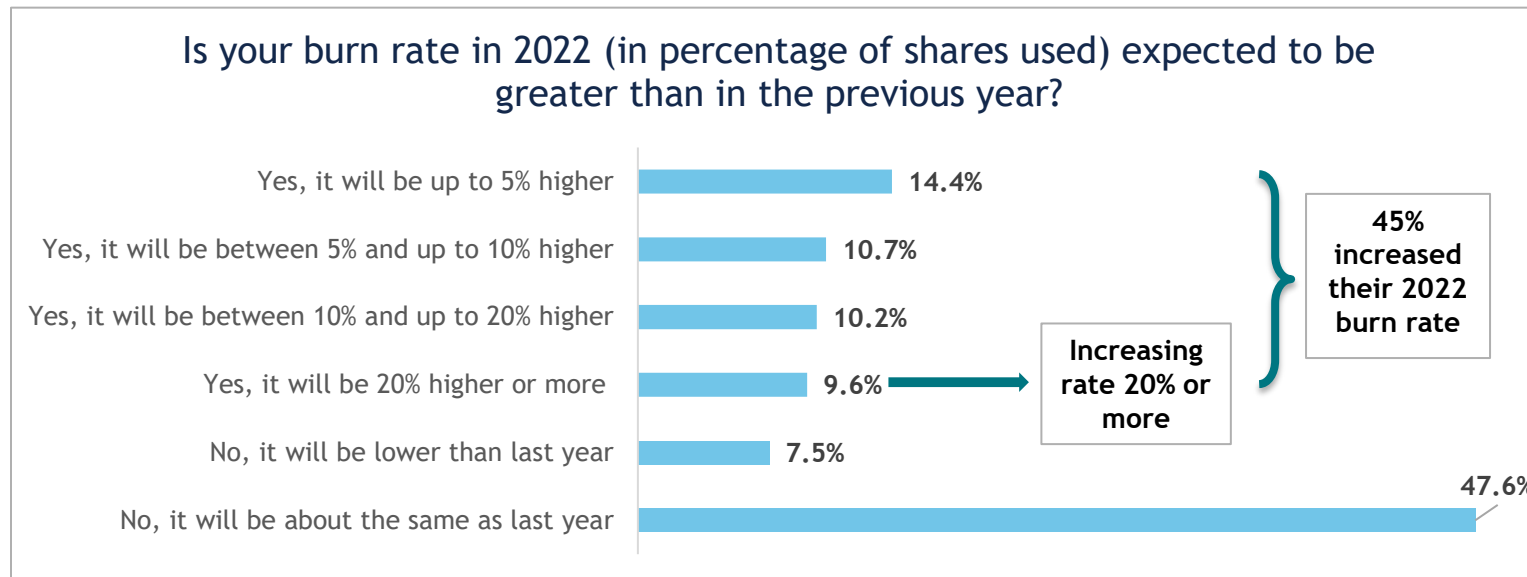
- Many are enhancing equity grants for new hires—at the most senior levels and below.



Burn Rates Are Increasing



- Almost 45% increased their 2022 burn rate, with almost 10% increasing this rate 20% or more.
- Although most organizations did not go deeper with their equity grants, many have higher burn rates due to depressed stock prices and increasing competition for talent.



Polling Question #1

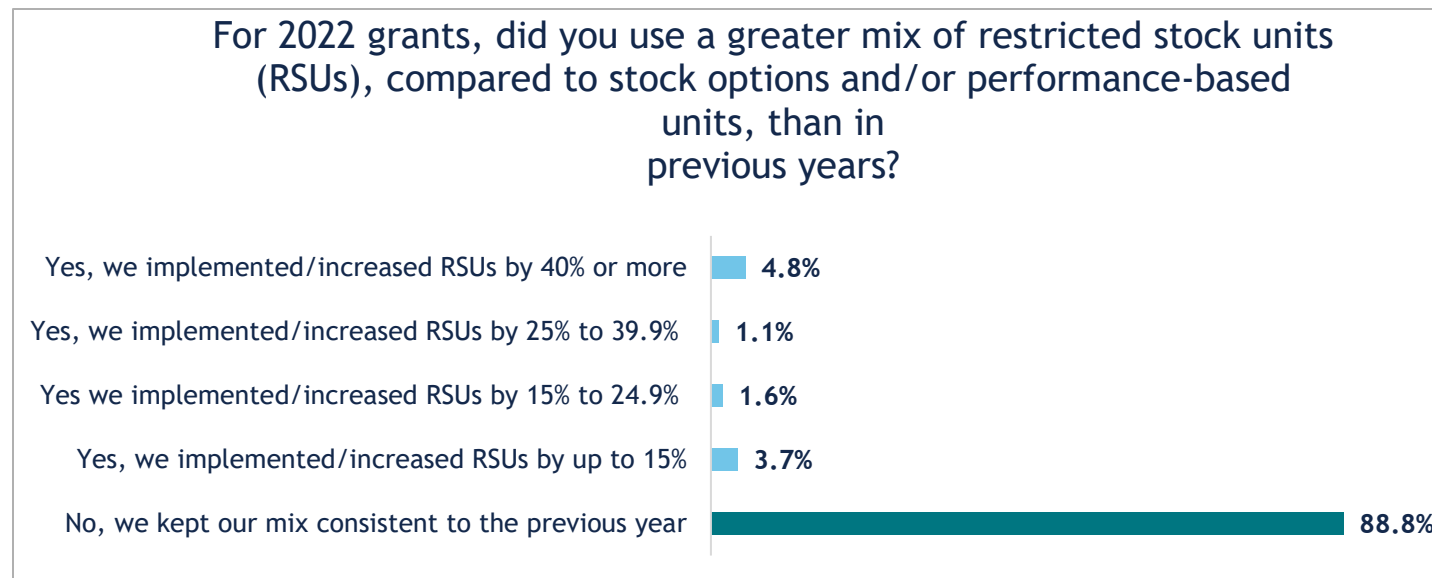


- How concerned are you about increasing stock-based compensation expense or increasing burn-rates?
 - Very concerned
 - Concerned
 - Somewhat concerned
 - Not concerned

RSUs Are Gaining Favor

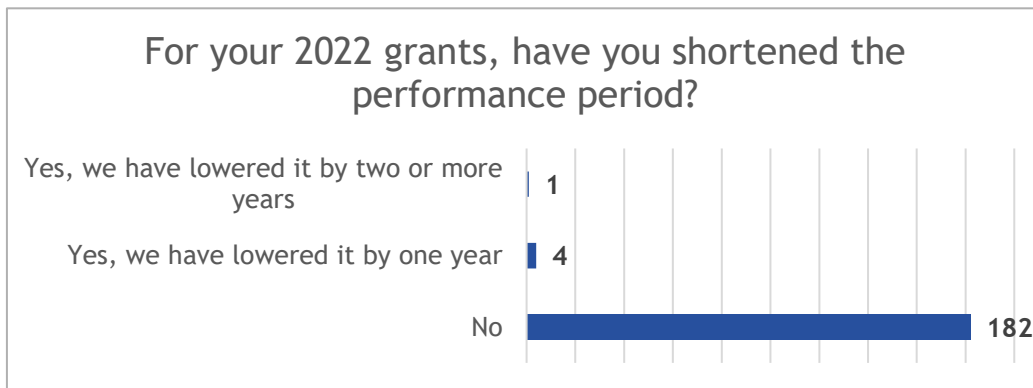


- The increase in use of Restricted Stock Units (RSUs) reflects the volatility of 2021.
- About 10% increased the use of restricted by 15% or more, which is a meaningful change. Interestingly, of the companies that indicated making a change, 52% increased by $\geq 25\%$.

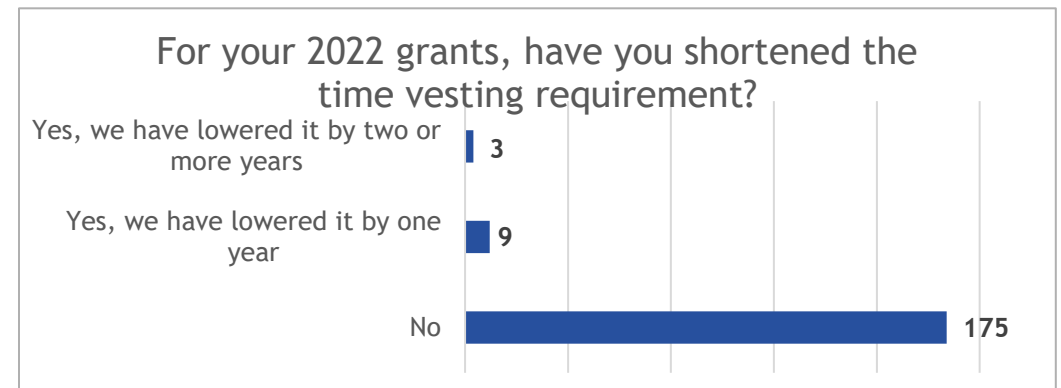


What's Not Happening...

Shorter performance periods: Of the 187 respondents, only a handful of firms shortened the incentive plan's performance period, suggesting the economic conditions did not raise material concerns about the ability to set goals.



Shorter vesting periods: Similar to the responses on shortening performance periods, very few companies felt it was necessary or desirable to shorten the time-vesting equity schedule.

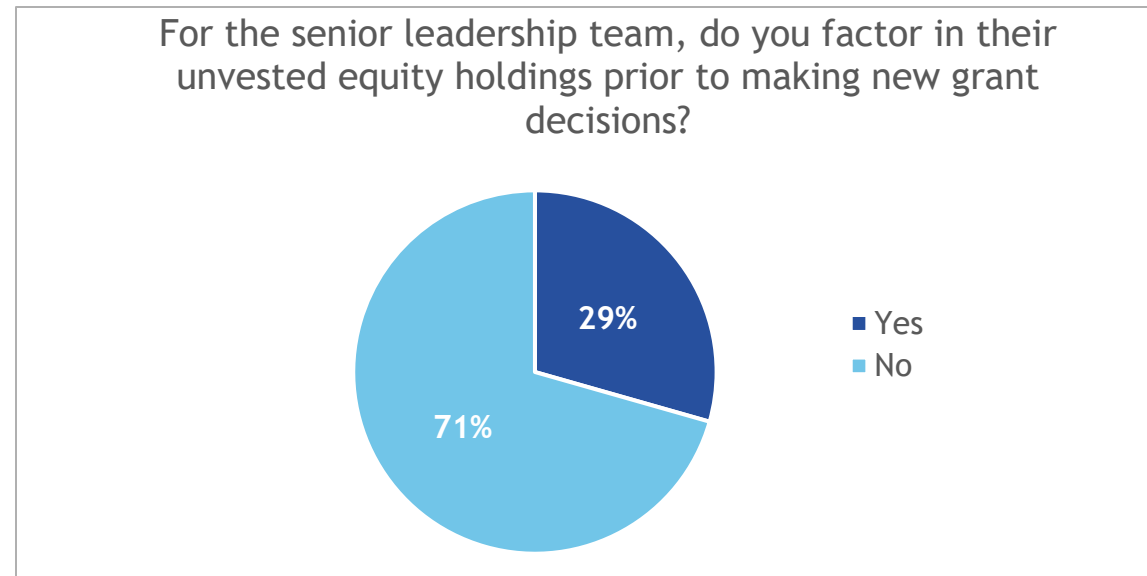


However, in a tight labor market, these compensation plan design practices could be seen as more employee-friendly.

...And Unvested Equity Isn't Examined



- A little less than a third of companies take into account the unvested equity holdings prior to making new grant decisions.



Holding Power and Buy Out Risk are Important Inputs



- Prior to determining an individual’s annual equity grant, companies should consider an individual’s unvested equity holdings alongside collecting data on market competitive equity grants.

Holding Power as Multiple of Salary -
Good Indicator of the Magnitude of Unvested Holdings

Position	Unvested as Multiple of Salary as of Dec				
	2022	2023	2024	2025	2026
Chief Executive Officer	6.8x	7.4x	4.0x	0.4x	0.0x
Chief Technology Officer	3.2x	3.7x	2.2x	0.0x	0.0x
Chief Marketing Officer	0.0x	0.0x	0.1x	0.4x	0.0x
Chief Product Officer	6.7x	8.0x	5.6x	0.0x	0.0x
Chief Financial Officer	3.8x	3.2x	1.9x	0.5x	0.0x
Chief Operating Officer	0.0x	0.0x	0.0x	0.0x	0.0x
Chief People Officer	3.1x	3.2x	1.4x	0.0x	0.0x
President	1.4x	1.4x	0.6x	0.0x	0.0x
Chief Revenue Officer	3.0x	2.2x	1.7x	0.7x	0.0x
General Counsel	1.7x	1.2x	0.8x	0.4x	0.0x
For CEO	≥ 5.0x		3.0x - 5.0x		≤ 3.0x
Sr. Leaders	≥ 4.0x		2.0x - 4.0x		≤ 2.0x
Others	≥ 3.0x		1.0x - 3.0x		≤ 1.0x

Holding Power as Multiple of Market 50th Annual Equity Grant -
Good Indicator of “Buy-Out” Risk

Position	Unvested as Multiple of Mrkt 50th Equity as of Dec				
	2022	2023	2024	2025	2026
Chief Executive Officer	2.3x	2.5x	1.4x	0.1x	0.0x
Chief Technology Officer	4.0x	4.6x	2.7x	0.0x	0.0x
Chief Marketing Officer	0.0x	0.0x	0.1x	0.5x	0.0x
Chief Product Officer	8.3x	9.8x	6.9x	0.0x	0.0x
Chief Financial Officer	2.2x	1.8x	1.1x	0.3x	0.0x
Chief Operating Officer	0.0x	0.0x	0.0x	0.0x	0.0x
Chief People Officer	4.2x	4.2x	1.9x	0.0x	0.0x
President	1.7x	1.7x	0.8x	0.0x	0.0x
Chief Revenue Officer	4.2x	3.1x	2.3x	1.0x	0.0x
General Counsel	2.3x	1.7x	1.1x	0.6x	0.0x
All Executives	≥ 3.0x		2.0x - 3.0x		≤ 2.0x

Polling Question #2



- Have you noticed an uptick in questions from employees about equity compensation in the last 12-18 months?
 - Yes
 - No
 - I Don't Know

Polling Question #3



- Does your organization provide its managers with education materials on how equity compensation works?
 - Yes
 - No
 - I Don't Know

Pay Transparency Applies to Equity, Too



- Equity awards may be emerging as a standard expectation.
 - Grants are more common across the workforce.
 - More generations in the workplace are being fully open about pay.
- Companies need to be prepared to address how they use—or don't use—equity as part of their total compensation strategies.
- Staying silent or discussing equity on a case-by-case basis can lead to misunderstanding and mistrust.

Communication Action Steps



Clearly articulate how equity compensation fits into the overall compensation philosophy—not just the executive compensation philosophy.



Provide education materials HR teams, people managers, and new hires that explain the mix of equity being used, the purpose of the mix, and how each equity vehicle works.



Reinforce with managers the key messages they should be championing with all their direct reports, including those who may not be eligible for equity awards.

Questions

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