

HOW TO DESIGN AN EFFECTIVE EXECUTIVE COMPENSATION PROGRAM

Overview

Today more than ever before, executive compensation gets high-priority press in publications around the world. Boards, senior management teams, and shareholders are constantly struggling with how to design the right type of executive compensation plans. If you-like other executives-are frustrated with making sense of this ever-changing landscape, come learn from our panel of experts how to design an executive compensation plan that works. We'll cover plans that will drive shareholder return but also attract, retain, and motivate your top executives to achieve business success.

Workshop Objectives

- Factors to consider when developing an executive compensation strategy
- What are the components of an executive compensation program
- What is the Board's role in executive compensation design
- How best to work with the Board of Director's on executive compensation issues
- Issues that should be considered for both public or private companies when designing an executive compensation program
- Financial information that should be provided to the CEO and the Board regarding executive compensation plans
- Importance of developing a human capital strategy that is connected to your business strategy

Workshop Timeline

- Introductions
- Executive Compensation Problems facing the Audience
- Panel Discussion
- Q & A

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Workshop Leaders

Session Leader

Jim Geier *President, Human Capital Consulting Partners*
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Jim Geier is President and Founder of Human Capital Consulting Partners a human resources consulting firm. Jim works with his clients to help them solve their "people problems" by focusing on business strategy, business issues, and organizational dynamics to design and implement practical and effective human capital solutions. Previously, Jim was Vice President, Human Resources and a member of the senior management team at Quaker Chemical Corporation. Before Quaker, Jim was Vice President, Human Resources for the Americas Region at Rhône-Poulenc Rorer Pharmaceuticals (today Sanofi-Aventis). Jim serves on the Board of Directors at Franklin Mint Federal Credit Union, where he chairs the Human Resources Committee of the Board, Philadelphia Young Playwrights, where he chairs the Board Development Committee, and is a member of the Executive Committee.

John Bond *Senior Financial Executive, Company*
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John Bond is a senior financial executive with more than 25 years experience in growth- driven, complex international environments with a focus in life sciences. John has proven abilities in strategic planning, mergers and acquisitions, investor relations, treasury and information systems. John thru his leadership, customer focus and value added approach has created for various organizations strong financial disciplines directly connected to the company's business strategy and in pursuit of continuous improvement. Mostly recently, John was Vice-President and Chief Financial Officer, Cytokine

Pharmasciences Inc., where he was responsible for worldwide finance, treasury, manufacturing and led the development of the UK market. Prior to this John worked for Sanofi-Aventis, Biotechnology General Inc., and Solution.com.

Henry (Hank) Boyer *Vice-Chairman and Chair-Compensation Committee, VoiceVerified, Inc*
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Hank is currently Vice-Chairman and Chair of the Compensation and Nominating Committees and a member of the Board of Directors for VoiceVerified, Inc., a leading identity authentication firm headquartered in New Hope, PA. They authenticate identities using voice, the unforgettable password™, for the financial services, telecommunications, health-care, education and public sectors. In addition, Hank is founder and a principal of Boyer Management Group, a consulting firm that works with companies that want to get the very best from their people and with senior executives that want to improve their effectiveness. Prior to forming Boyer Management Group, he served as chief operating officer at Campus Dimensions Inc /Frontline Event Marketing. He has also held senior positions at Comcast Cellular Communications, Future Electronics and Tandy Corp. He has published more than 100 training programs in leadership, sales, customer service, compliance and human capital.

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Potential Questions for the Panelists:

1. How important is the strategy and the operating plan in establishing the compensation program for executives and employees?
2. How should the operating plan be prepared and what elements should it include?
3. How key is the culture in gathering the hearts and minds of those working within the enterprise?
4. Will management by objectives work and what tools and methodology are required?
5. Typically the annual budget is used to measure performance; is this effective tool?
6. Based on the strategy and operating objectives what elements of compensation should be included in the program to ensure success and how should their weighting be determined?
7. Each employee will generally have different risk/reward profiles, how does a new enterprise meet individual requirements for the founders, senior executives, as well as the Board
8. What deliverables should the enterprise be measuring and how is this best accomplished?
9. Demonstrating the ongoing growth in the enterprise value is important. Knowing that the initial years following start up are typically dedicated to research and/or development, can this be achieved?
10. The compensation program will include benefits; what benefits should a start-up consider and why?
11. What financial issues should be considered when providing for a share options?
12. Are employee contracts necessary for all or only senior executives?
13. Is it too early to plan for a change of control and the impact on employees' compensation and job security?
14. What is the role of the board of directors in establishing the company's executive compensation practices?
15. How does the compensation committee of a board work (what are its mechanics)?

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Potential Questions for the Panelists:
(Cont'd)

16. How does a company's executive compensation approach fit into the entire aspect of a company's compensation?
17. What are the top three things that you look for in a company's executive compensation plan to see whether or not it is effective?
18. What are the components of an executive compensation program that might be specific to the executives (and not to the non-executive employees)?
19. What are the top three caution areas to consider when evaluating an executive compensation program?
20. How do the executive compensation approaches differ from a small private / family owned company versus a startup that is looking to do an IPO or be acquired versus a public company?
21. How does executive compensation differ in each of the first few years of a start-up?
22. What are some of the tools that you use when establishing and evaluating executive compensation programs?
23. What do the shareholders want to see from an executive compensation program?
24. What are the principal attributes of an effective executive remuneration program?
25. How does a company design a compensation strategy that achieves these attributes?
26. Describe the key regulatory events affecting executive pay over the last few years?

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Potential Questions for the Panelists:
(Cont'd)

27. What are the primary constraints and challenges that public companies face in the design and administration of executive pay?
28. Do these constraints / challenges differ for private companies?
29. In light of these obstacles, what are the most effective ways to align the long-term economic interests of executives and owners?
30. What is the appropriate balance between long-term incentive compensation and annual bonus compensation?
31. With respect to incentive plans, how should performance be measured and how should specific goals be set?
32. Currently, what are the most contentious issues in executive pay and what pitfalls do these present?
33. What are the major trends you have observed in executive compensation over the last few years and what are your expectations for the future?

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Hot Compensation Tips for Growing and Developing Your Business

1. Develop appropriate governance protocols, including a compensation committee charter and documentation articulating the compensation strategy.
2. Ensure that the compensation program is aligned with the business and human capital strategies. For example, a compensation program with a modest risk / reward profile is generally inappropriate for an early-stage company financed with private equity. Similarly, an incentive plan based on free-cash flow would be counterproductive for a growth company with minimal operating cash flow and a strategic plan to make significant capital expenditures over the next several years.
3. Evaluate the program's alignment with shareholder interests and expectations. The program should fairly allocate value creation between executives and shareholders. Equity dilution should be reasonable vis-à-vis competitors and performance goals should generally align with investor expectations.
4. Engage experts, including tax and securities counsel, accountants, and compensation consultants. The world of executive compensation has become incredibly complex and is subject to intense scrutiny – there is too much at risk to “go it alone”.
5. Understand your labor market and conduct periodic benchmarking analyses to ensure the compensation program is competitive.
6. Understand how all elements of compensation work together and the aggregate opportunity they represent.
7. Align compensation closely with the specific objectives you want to achieve – all too often a compensation approach will reward performance that may be good for the individual but at cross purposes with outlined organizational goals.
8. Compensation should always reflect a balance of risk and reward. Thus, some level of both guaranteed compensation and variable, performance-based compensation is going to be needed to attract, focus and retain top talent.
9. Put the compensation plan in writing, with examples of how variable compensation might be earned. People need to see concrete examples of what performance equates to what compensation.
10. Don't be afraid to change your compensation plan if it is not working. All compensation plans should contain language that enables them to be changed to address the needs of the business, new opportunities, a changing marketplace, etc.
11. For start-ups, working for sweat equity is terrific, with out-of-pocket cash investments in the company even better. When an individual has invested his or her own money in the business, there is a greater level of commitment to it than someone who just works for sweat equity.

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Hot Compensation Tips for Growing and Developing Your Business (cont'd)

12. Ensure that you have the right mix of talent on the team, not just knowledge and experience. While experience is a great indicator of skills and knowledge, talent is what they are born with. Because you cannot teach it – you can only develop it – your compensation plan must reward talent accordingly.
13. “Culture eats strategy for breakfast”: strategize all you like but if you have not got the hearts and minds of those working for you in the business it is a complete waste of time.
14. Keep flexible; compensation cannot be treated in isolation as change in business processes, enterprise structure and or people should trigger a review of the compensation program.
15. It is never too soon to adopt best practice. Public companies are required to include a Compensation Discussion and Analysis (CD&A) in their SEC filings. The CD&A requires narrative disclosures which must address six principal topics which provide a very useful checklist for a start-up to work through in the determination of a compensation program:
 - a. Objective of the compensation programs
 - b. What the programs are designed to reward and not reward
 - c. Elements of compensation
 - d. Reason for each element
 - e. Determination of the amount of each element
 - f. Relationship of each element to others and to overall compensation objectives
16. Stick to the basics and keep the program simple: well understood outcomes and straight forward and fair performance measures will carry the day.
17. Seek expert advice: At an early stage seek advice from legal council, corporate auditors and benefit experts. Tax (corporate and personal), financial reporting and accounting treatments all need to be understood
18. Expect the unexpected: actual results differ, people leave, business valuation go down, investors become more demanding, more cash required. Challenge and test the program.
19. Meet with Compensation Committee members on an individual basis at least two times a year to check in and be sure their needs are being met.
20. Send material that will be discussed at the Compensation meeting at least one week prior to the meeting to allow Committee members time to review before the meeting.
21. Develop in conjunction with the Chairperson of the Compensation committee an annual calendar of events to be discussed at each Committee meeting.

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Notes



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Terrific Resources for Building Executive Compensation

1. The National Association of Corporate Directors (NACD) provides excellent guidance on compensation, corporate governance and the like. Specific compensation tools include guidance on executive compensation, board governance, compensation committee of the board and board compensation. www.nacdonline.com
2. The Ladders – a free service to post jobs for positions of \$100,000 and up as well as search on resumes to executive level candidates. The ladders is the world's largest community catering to the \$100K+ job market, with specialization in Sales, Marketing, Finance, Human Resources, Law, Technology, and Operations. www.theladders.com
3. Annual reports, notices of annual shareholder meetings and 10-k forms filed by public companies provides information on compensation benchmarks by the larger companies, and offers insight in to executive compensation structure. Often available online, consider searching industry leaders in the industries which you serve.
4. Salary.com, along with most major online employment search engines such as monster.com and hotjobs.com, offer rudimentary compensation information across various job categories and functional areas. Caution: these figures may or may not reflect the actual value of the positions you are considering.
5. Well-detailed and accurate job descriptions are an important starting point to allow you to assess the knowledge, skills and talents required for each open position. Some job description software may additionally incorporate PEP (position evaluation program) scoring, which allows you to grade all positions in your organization, then subsequently assign salary grades equitably for all positions across the organization.
6. Some executive search firms provide free or low-cost resources to assist you in determining executive compensation. Example: Robert Half & Associates.
7. Several organizations, including chambers of commerce, trade organizations, and the statewide manufacturer's extension program (NJMEP in New Jersey www.njmep.org and the DVIRC in Philadelphia (www.dvirc.org) all provide compensation data from and to members.
8. SHRM, the Society for Human Resources, provides salary data online to its members www.shrm.org
9. www.cfo.direct.com Price Waterhouse online resources for CFO's
10. www.sec.gov Securities Exchange Commission moniyir latest changes in reporting for public companies

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Terrific Resources for Building Executive Compensation

Books

The 4-Dimensional Manager – Julie Straw (Berrett-Koehler Publishers)

The GE Way Fieldbook - Robert Slater (McGraw Hill)

First, Break All the Rules - Marcus Buckingham & Curt Coffman (Simon & Schuster)

Now, Discover Your Strengths - Marcus Buckingham & Donald Clifton (Free Press)

The One Thing You Need to Know - Marcus Buckingham (Free Press)

Good to Great: Why Some Companies Make the Leap. . .and Others Don't, Jim Collins

The HR Scorecard – Brian Becker et al (Harvard Business School Press)

The Tipping Point: How Little Things Can Make a Difference, Malcolm Gladwell

Keeping the Best - Martin Yate (Bob Adams Inc)

Human Capital Edge – Bruce N. Pfau (McGraw Hill)

Topgrading – Bradford Smart (Prentice Hall)

“The Quest for Value: by G Bennet Stewart (Stern Stewart)

“Harvard Business Review on Measuring Corporate Performance”

“Valuing a Platform Biotech: Path Towards Profitability” published by Morgan Stanley October 15 2002.

Websites

www.shrm.org

www.nacdonline.org

www.theladders.com

www.World@Work.com

www.Compensationstandards.com

Magazines and Trade Associations

National Association of Stock Plan Professionals

Society of Human Resource Professionals

National Association of Corporate Directors

CFO Magazine

Chief Executive

Directors & Boards

World@Work

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Sample Compensation Strategy

- Have high proportion of total compensation related to performance
- Total pay includes base, annual cash incentive, and equity-based long-term incentive
- Manage the mix of compensation in relation to job level
 - Mix of fixed and at-risk pay -- The higher the level the more at risk
 - Mix of annual and long-term at - risk pay--The higher the level, the more long – term
- Base incentive payments on measures of performance directly related to creating shareholder value
- Assure external competitiveness and internal equity
- Target base pay at the 50th percentile
- Target total compensation to meet or exceed the 75th percentile at times of outstanding financial performance

Sample Annual Bonus Design

- Purpose to provide cash incentive for year - to - year earnings performance
- Award set as a percentage of individuals' base salary based on market competitiveness
- Metrics based on annual profit before tax objectives
- Bonus payout targets set in context of performance expectations versus prior year's performance and current year's budget

Sample Long Term Incentive Design

- Purpose to provide an opportunity for highly competitive levels of total compensation for senior management if merited by performance over time
- To create a strong incentive to perform over a multiple year period and provide balance to short term incentives
- To develop a tangible alignment between the interests of executives and those of shareholders
- To provide a wealth building opportunity for senior management
- To attract and retain talent
- Metrics based on mix of return on assets(ROA) and earnings per share(EPS) over three years
- Awards set as a percentage of individual's base salary, and consist of a mix of stock options, restricted stock and cash
- Actual award payout may vary from 0 to 2x target award