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Commentary

The New Equity Compensation Map

How Do We Get There from Here ... and Where Is 'There'?



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EDITOR'S NOTE: This article is co-authored by two consultants with similar philosophies but different technical orientations. The content is not in its entirety mutually endorsed by both authors, and reflects a mutual agreement to disagree to provide a meaningful view of alternatives. The views expressed are solely those of the authors and do not represent an official position of WorldatWork or WorldatWork Journal.

Recent media coverage may lead one to believe that the Enron/Tyco/Worldcom scandals triggered questions about the accounting treatment of stock options leading companies to consider abandoning broad-based options plans if options must be expensed under revised accounting rules.

That headline-friendly version is quite misleading. In 1995, after a 10-year battle, the Financial Accounting Standards Board (FASB), under intense political pressure, backed away from outright option expensing. This time, the current business scandals coincided with a global move toward revised option accounting. As the booming equity markets turned down, with little hope of a return to the growth rates of the 1990s, and as shareholders

exerted pressures on companies regarding the dilution created from overuse of stock-based compensation mostly at top executive levels, a “perfect storm” was created: Shareholders question the use of options, accounting critics seem to be finally getting their way and companies question whether the use of a more “expensive” option is warranted as we move into a low-growth equity world.

This quite different and more complex version of events will lead to a comprehensive overhaul of the use of equity in employee compensation plans. Where do we need to go, and how do we get there in light of these complex but often conflicting points of view?

Where Are We Now?

The aforementioned scenario points out four converging forces that have created the current focus on equity plans:

- ▶ **Companies’ stock option program design and granting practices.** It should come as no surprise that the combination of annual option grants, unprecedented stock price gains, relatively fast vesting schedules and cashless exercise programs resulted in a short-term “take the money and run” attitude among optionees. Executive ownership guidelines instituted by many companies have done little to offset these features. And while many employees have benefited greatly from these programs, others have never realized any compensation from their option grants, leaving some employers with a combination of turnover of “haves” and under-compensation of “have-nots.”
- ▶ **Stock-based compensation accounting rules in the United States.** Debated now for nearly 20 years, the existing accounting rules result in a great inconsistency in accounting treatment among stock-based compensation programs. As one of the clearest examples, and a favorite of such critics as Warren Buffet: How can an indexed option, designed to provide less compensation value in a rising market, incur an expense while a fixed

price option, designed to provide more compensation value, has no expense? Similarly, the vastly differing treatments of a fixed price stock option exercised through a cashless program versus a stock appreciation right defies economic rationale and common sense. (See Figure 1.)

FIGURE 1 A Primer in Stock Plan Accounting

Since its adoption in 1972, APB 25 has been the accounting standard for stock options that presaged the widespread use of stock options during the 1980s and 1990s. If a stock option is granted for a fixed number of shares at a fixed price, no expense for that option appears on the company's financial statements. Other forms of stock-based compensation require a fixed expense, such as restricted stock, or a variable expense, such as performance shares. Thus a company could potentially deliver significant amounts of compensation through stock option awards without incurring an expense as required with other forms of equity compensation and reducing reported profit.

- For example, under APB 25 a fixed price stock option granted on 1,000 shares at a strike price of \$20 when the company's fair market value is \$20 on the date of grant requires no expense to be reported. If the company instead granted 1,000 shares of restricted stock on the same date, the expense would be $\$20 \times 1,000 = \$20,000$ which would be spread over the vesting period.

With the introduction of FAS 123 in 1995, an alternative standard became available for companies, allowing choice of this new standard or continued use of the old standard. While only a handful of companies initially chose to use FAS 123 for financial reporting, all companies must include the calculation in the footnotes of their financial statements. This element of choice perpetuated the use of fixed-price stock options as companies continued with expense-free income statements and stock option expense calculations buried in the extensive pages of footnotes required.

- For example, under FAS 123 a fixed price stock option granted on 1,000 shares at a strike price of \$20 when the company's fair market value is \$20 on the date of grant requires that an expense be recognized based on an option pricing model such as Black-Scholes. The amount of this expense depends on several factors but would typically range from an expense of \$6 to \$14 per option, for an expense of \$6,000 to \$14,000 versus no expense under APB 25. The expense is spread over the vesting period.

Now, with the IASB proposal, issued in late 2002, on the table, it appears that the move toward unified global accounting standards ultimately will force U.S. accounting standards in the direction endorsed by most other countries. This includes recognizing an expense for stock options. The proposed standard is complex and differs from FAS 123, but has the same essential impact: All forms of stock-based compensation will result in an expense on companies' income statements, thus opening the door to new cost-benefit evaluations.

- Under these proposed standards the expense calculation is similar to the FAS 123 method but subject to a more complex accrual and recognition process.

▶ **Global business trends.** Over the past few years, equity compensation's role in the global business environment became much more prominent. Not only did U.S. multinationals extend broad-based option plans worldwide, but also companies based outside of North America began to emulate the U.S. compensation model for competitive reasons. This was further fueled by the privatization movement, which in many companies was supported by distribution of equity to all employees. As a result, the aggregate impact and visibility of equity plans has skyrocketed.

▶ **Macroeconomic and political forces.** Finally, there's no arguing that the high-profile chain of events that inevitably accompanies the burst of a financial bubble has fueled the already smoldering issues into a raging conflagration. The substantial decline in the equity markets, which rendered many employees' options and/or retirement savings worthless, added emotion to the ongoing executive compensation debate. With new data points indicating not only greed but also fraud, the stage has been set for questioning practices that have been the norm for the past 15 to 20 years. And of course the media are more than happy to publish non-sequiturs linking the Enron 401(k) situation to stock options.

Where Do We Go Next?

Despite the popular notion that accounting rules will be the sole driver of the next generation of long-term incentive plan design, it's not quite that simple; there will, in fact, need to be a multifaceted view of design tradeoffs. While the accounting expense issue may be resolved by year-end, considerations of compensation strategy, investor reaction, taxation and ownership dilution will compete for, and often override, the attention given to the earnings impact of stock plans. The interactions of these factors are complex with no obvious and clear choice. Some companies already have publicly stated that free cash flow is more important

than noncash earnings and designed new stock programs accordingly. Others have bowed to the pressure of institutional investors and changed stock option granting practices to meet annual "run rate" and total overhang goals.

Most importantly, these changes in accounting, investor perception and capital markets produce an opportunity for a fresh start in stock plan design, encouraging the revisitation of tools and methods abandoned under stock option-obsessed compensation design culture of the 1980s and 1990s.

The goal sought has not really changed. All seek to align the interests of shareholders and executives/employees using compensation tools that optimize financial efficiency. While there is little or no disagreement on the foregoing, there is heated debate on how to produce the "alignment" and on the definition of "financial efficiency." To paraphrase Yogi Berra's often misstated quote, it is critical to know our destination before we begin our journey. Yet, current dynamics are requiring companies to begin the journey without knowing the true destination and without the benefit of an accurate map.

Stock plan designers will have to find a way to balance the following considerations in a rapidly changing environment — particularly those that result in changes that are favorable for accounting and investor relations purposes, but potentially negatively received by employees:

- ▶ Compensation strategy — the role of stock-based awards in total compensation strategy
- ▶ Competitive trends — how other organizations are responding to these changes
- ▶ Accounting impact under APB 25, FAS 123 and any potential international standard
- ▶ Tax impact on and flexibility for the employee
- ▶ Dilution of EPS and ownership positions resulting from stock-based grants
- ▶ Investors' perceptions of stock plans.

All of these, with the exception of competitive trends (still to be determined), are examined in the following review of alternatives.

What Are the Alternatives?

Because many, perhaps most, organizations will in the near term merely modify existing stock option programs, it is important to consider these alternatives first.

Revisiting stock option design with a clean slate should result in reconsidering each of the following:

- ▶ Option grant timing
- ▶ Option grant price
- ▶ Option vesting schedule
- ▶ Option term
- ▶ Option exercisability
- ▶ Option exercise methods.

Note that the alternatives presented below will have a greater or lesser accounting impact depending on the resolution of the stock plan accounting issue. Some may be favorable today under APB 25, but less favorable under a FAS 123 or IASB approach, and vice versa. This discussion presumes that accounting will be one of many considerations and not a sole determining factor in plan design.

Option grant timing

The recent practice of large at-hire grants followed by smaller annual grants had at least some of its roots in the “get your options now while the price is low” mentality. With moderated price growth and increasing volatility, this model may no longer be favored. Perhaps a “dollar cost averaging” approach, with quarterly or even monthly grants over time will make more sense. This practice cannot be revised, however, without attention to other stock option features.

Example: New employees receive a series of four grants over the first year of employment, with vesting commencing on all four grants at the date of hire. Subsequent annual grants, limited to high performers and critical retention situations, are granted in two grants at three and six months after the award determination.

Option grant price

Perhaps the greatest strategic opportunity comes from variations in the option grant price, whether through discounted options, premium priced options or indexed options. While the debate over these alternatives centers on accounting treatment, if companies should find a sudden new market mentality that noncash charges don't matter these alternatives become much more attractive.

For example, consider discounted options that provide an opportunity to convert current cash compensation (a new hire bonus, or an annual incentive award) into deferred, stock-price influenced pay.

Example: In lieu of a signing bonus of \$150,000 for a critical executive, the new hire grant of 50,000 options is discounted \$3.00 below the fair market value at date of grant ($\$3.00 \times 50,000 = \$150,000$). This amount now is shifted from a cash expense to a noncash expense; the ultimate award value depends on stock price performance; and the employee has the flexibility to determine when the award is received by exercising the option.

Example: Rather than a typical option grant with a strike price at fair market value, the company grants an option with the price indexed to the price movement of a peer group of 20 companies. If the economy and stock market recover and a bull market resumes, the employee will only experience an option gain if the company stock price outperforms that of its peer group. If this industry should continue in the doldrums or experience a greater decline, however, the employee might end up with an option gain even if the company's stock price declines – as long as it declines less than that of its competitive peer group index.

Option vesting schedule

At the executive level, the short-term nature of option vesting is contrary to the long-term mission entrusted to executives by investors. While the typical vesting period may extend in total for four or five years, incremental vesting often begins after only one year.

Conversely, option vesting may not be an appropriate tactic to encourage retention in all cases. Perhaps immediate commencement of monthly vesting

provides the right balance between retaining “keepers” versus discouraging “dead weight” from leaving.

Example: Rather than a standard schedule – 25 percent per year over four years, or 25 percent after one year then monthly vesting for three years thereafter – a company attaches a vesting schedule of 25 percent every six months. When coupled with appropriate changes in new hire grant and annual grant size, this may actually enhance the ideal mix of retention and turnover, make option gains more realizable in a volatile market, and support shorter option terms.

Example: A high-performing employee just promoted to vice president in charge of the company’s biggest operating division receives a promotional grant of 100,000 shares with vesting occurring only at the end of five years. If the division meets or exceeds its aggressive growth goals, however, the vesting may be accelerated to 33 percent at the end of years two, three and four.

Option term

Many companies will use option term reduction as a tactic to both reduce fair value under option pricing models, thus reducing the reported expense of options, and to reduce overhang by forcing earlier exercise. Since 10 years may be beyond the horizon of motivation and influence for nearly all optionees except those at the very highest executive levels, this alternative has great merit.

Example: A company provides a new hire grant with a five-year option term and two-year vesting, and selective annual grants to some, not all employees, with five-year terms and three-year cliff vesting – focusing grants on retention-based compensation for high performers.

Example: A company with a high level of overhang and a large proportion of its outstanding options underwater needs a short-term retention device to retain employees during the next 18-month turnaround period. It grants an option to all employees with an 18-month cliff vesting schedule and a 24-month term (sometimes called a “stub grant”). This focuses employees on remaining during the turnaround period and, assuming the company is successful and the market responds to the strategy, a compensation opportunity during the following six-month period. At this point, some of the underwater options also should be back in the money, restoring their incentive and retention value.

Option exercisability

In California’s Silicon Valley, the ubiquitous “California Style Option” exemplifies the fact that vesting and exercisability can in fact be separate concepts. Here, options can be exercised early in their terms to lock in gains and start capital gain holding periods, but still be subject to a diminishing repurchase right for the company and achieve the same retention impact of traditional option vesting/exercise schedules.

Example: A company provides the grant, term and vesting described above, but allows exercise at any time during the vesting period, enhancing the employee’s flexibility for tax planning and balancing risk with after-tax gain opportunities.

Example: A company provides a standard fixed-price option with four-year cliff vesting (100 percent vested at the end of the fourth year, no incremental vesting). The option is exercisable when vested — but, if the company exceeds a performance target at the end of years one, two, and three, 25 percent of the option will be eligible for early exercise, as described in the example above.

Option exercise method

Since the widespread adoption of the cashless exercise method in the late 1980s, little has been questioned about this “take the money and run” approach to stock-based compensation. The simple adoption of a sell-to-cover taxes and proceeds only requirement (with a brokerage commission due on the sale of any remaining or “profit” shares), while still allowing an almost-immediate cash-out, would provide one less incentive to completely divest all shares. Coupled with a holding requirement, the conveniences of cashless exercise can be maximized while minimizing the obvious abuses that dampen the impact of a long-term incentive strategy.

Example: A company grants options to those in salary grade 15 and above that may only be exercised using the cashless method if the employee does a sell-to-cover and holds the shares for two years after exercise. Otherwise the employee must do a cash or stock-for-stock exercise.

Life Without Options

Many, perhaps most, companies ultimately will abandon options altogether due to their various cost aspects: accounting charges, poor cost/benefit ratio and high share-per-compensation dollar ratio. This further opens the door for creative compensation plan design that better links strategy, financial effectiveness and behavior. The most likely of these alternatives (from least to most attractive) include:

- ▶ Restricted stock
- ▶ Restricted stock units
- ▶ Stock-settled stock appreciation rights
- ▶ Performance shares.

Example: Rather than 5,000 options, a company awards 1,500 shares of restricted stock based on an analysis of the projected compensation value of the respective grants. The analysis considers both the intrinsic value and the potential gain value of the two awards.

Example: To conserve cash and encourage retention, a company pays a portion of its annual incentive award in restricted stock, with a premium in the conversion ratio to recognize the mandatory deferral of the award and the increased risk. An employee who earned a \$50,000 bonus under the plan receives \$25,000 in cash and 1,000 shares of restricted stock that has a current value of \$35,000 (\$35 per share market price). The stock vests 100 percent at the end of two years.

Restricted stock

Not that long ago, restricted stock was portrayed as nothing more than the executive compensation equivalent of the step-based wage system, rewarding continued employment and ignoring performance. Now, with accusations of stock options as an incentive for financial manipulation, luminaries including former Federal Reserve Board chairman Paul Volcker have identified restricted stock as a better solution. At senior executive levels, this is a ridiculous over-reaction to the abusive actions of the few greedy and criminally pre-disposed, and opens the door for potentially even worse abuse. For lower levels, it may make sense as the compensation profession grows into the job of setting

distinctive long-term goals and measuring performance at various discrete levels company-wide.

Restricted stock units

Once a company concludes that restricted stock grants are a superior compensation solution to stock options, a variety of administrative issues surface. Restricted stock units provide flexibility to enforce resale restrictions, and non-compete and confidentiality obligations, beyond the employment relationship.

Example: Instead of the 1,500 restricted shares, the company grants 1,500 restricted stock units. Executives have the opportunity to elect to defer the income at vesting through a nonqualified deferred compensation arrangement and the company realizes reduced administrative and transactional costs and burdens.

Stock-settled stock appreciation rights (SSARs)

As companies accept FAS123 or a conceptually similar accounting standard and focus on dilution rather than accounting earnings, it will become clear that one alternative is to award stock appreciation rights (SARs) that are paid in shares, preserving a fixed accounting expense but requiring far fewer shares to be issued than if options were granted.

Example: A company grants 1,000 SSARs at a grant price of \$30. After completion of the vesting period, the stock has risen by \$15, to \$45. The company issues 333 shares (1,000 x \$15 gain / \$45 price), using only one-third as many shares as required with a typical stock option grant.

Performance shares

Many compensation consultants believe companies will turn to performance shares as their long-term incentive of choice.

Performance shares provide the opportunity to optimize the cost-benefit trade-off because of the focus on two or more balanced performance measures (internal and/or external financial performance and stock price performance) and their less dilutive and less expensive ability to deliver competitive pay levels in an option expense accounting environment.

The significant challenge companies will face with performance shares is goal setting. The same volatile environment that has brought option granting practices into question makes multi-year goal setting a challenging process.

Example: Rather than 1,500 restricted shares, the company grants 1,500 performance shares that will result in an award of 1,500 shares if the company reaches its cumulative free cash flow target of \$500 million dollars in three years. If 80 percent of the target is reached, 1,000 shares (67 percent of target) will be granted. If 125 percent of target is achieved, 2,000 (133 percent of target) shares will be awarded. The award value is determined not only by the number of shares, but also by the shares' value at the time of the award.

Example: Engineering managers overseeing a critical product development program are each issued 1,000 performance shares when the company stock price is \$50. If the product meets or beats its milestones and ultimate launch date targets, the number of shares may increase to as much as 1,500 shares. If more than one milestone date is missed by more than one week, the shares are forfeited.

From Plan Design to Plan Rescue, Transition and Integration

Finally, as the tradeoffs among cash, equity and deferred compensation become more important to consider, there may be a move toward integrating current "siloed" approaches to compensation. While option exchange programs and deferrals of cash compensation into performance plans are used today to a limited degree, they very likely will be put back on the table as core alternatives during the transition period of the next few years.

Option exchange programs

The current conundrum of high overhang levels produced by large grants of now-underwater options leaves companies in a lose-lose situation. Investors react negatively to the overhang levels resulting from extensive option grants and employees see no value, now or ever, in those same options. While the situation varies among companies, for many in the technology sector the options will never have value during the option life, or for that matter anyone's life.

Option exchange programs — whether options-for-options, options-for-cash or options-for-stock — when properly structured can produce a win-win for the company, employees and investors.

Example: A company offers its employees the opportunity to exchange existing underwater options for a number of shares equal to one-third the number of options. This restores the potential gain opportunity of the options while reducing the company's overhang. The vesting period on the underwater options is transferred to the new options, so employees get credit for time already accrued under the vesting schedule.

Example: A company offers its employees the opportunity to exchange existing underwater options for a number of shares equal to one-half the number of options, or receive a new option grant of a number based on the strike price of their existing underwater options. This company was less concerned about dilution, did not have a share price that had lost as much of its value as the company in the preceding example, and has a philosophy of allowing employees a degree of choice in compensation matters

Deferrals of cash compensation into performance plans

The corporate governance pressures leading to a call for a true long-term focus in executive compensation may lead more companies to the "Wall Street" model: current year pay delivered in long-term forms. While awarding a portion of annual bonuses in the form of restricted stock has been used in many companies, an effort to rebalance the cash/stock mix might find annual cash awards converted into cash-based long-term programs.

Example: A company with a current share price of \$25 pays 50 percent of its annual bonus awards in cash and 50 percent in performance shares with three-year cliff vesting. Thus, an annual bonus of \$50,000 is paid in \$25,000 and 1,000 restricted shares that may be worth substantially more or less than the original award amount based on company performance.

Example: A company believes that it already has an appropriate proportion of its executive pay program tied to company stock price through its stock options and performance shares programs. It decides to require deferral of 50 percent of annual bonus awards into a cash performance unit plan with awards based on revenue growth and operating margin. The company believes this provides an incentive to focus on these drivers of strategic value even if the overall stock market performance is not creating value for the stock-based awards.

FIGURE 2 Stock-based Compensation Practices: Alternatives in a Rapidly Changing Landscape

Type of plan or feature	Supports compensation strategies	Positively viewed by employees	Low cost per APB 25 accounting	Low cost per FAS123 accounting	Maximizes tax flexibility for employee	Helps manage dilution	Positive for investor relations
Stock Option Design Solutions							
Staggered grant date	●	■	●	■	●	■	●
Discounted option in lieu of cash	●	■	■	■	●	■	●
Indexed option	●	▲	▲	●	●	▲	■
Shorter vesting schedule	●	●	●	●	■	●	■
Accelerated vesting provision	●	●	■	●	●	●	■
Shorter option term	●	■	●	●	■	●	●
"Stub grants"	●	■	●	●	▲	●	■
Pre-vesting exercise	■	●	●	●	●	■	■
Performance-contingent pre-vesting exercise	●	●	■	■	●	●	●
Option exercise limitations	●	▲	●	●	▲	■	●
Stock-Based Solutions (without options)							
Restricted stock in lieu of options	●	■	▲	●	▲	●	■
Restricted stock in lieu of cash	●	■	●	●	■	■	■
Restricted stock units	■	■	●	●	●	●	■
Stock-settled SAR	■	■	▲	●	●	●	■
Performance shares	●	■	▲	●	▲	●	■
Option exchange	■	■	■	■	■	■	■
Deferrals of cash into performance plans	●	■	■	■	■	■	■

● Generally favorable ■ Depends on specific design ▲ Generally unfavorable

Plan Design Criteria	
Supports Compensation Strategies	Reinforces specific behavioral objectives of plan via plan design vs. impact of external forces
Positively Viewed by Employees	Is viewed by employees as a program equal to or better than the current standard stock option grant in terms of gain potential, flexibility, and/or individual influence on compensation outcomes
Low Cost per APB 25 (vs. alternative)	Provides a neutral or more favorable level of accounting expense - compared to the alternative cited in the example in the text of this article — under APB 25
Low Cost per FAS 123 (vs. alternative)	Provides a neutral or more favorable level of accounting expense - compared to the alternative cited in the example in the text of this article — under FAS 123
Maximizes Tax Flexibility for the Employee	Allows employee to elect the timing and/or type (ordinary income or capital gains) of taxation on the award given
Helps Manage Dilution	Provides a neutral or more favorable level of dilution — compared to the alternative cited in the example in the text of this article
Positive for Investor Relations	In general, is likely to be viewed favorably by outside investors compared to the alternative cited in the example in the text of this article — with the caveat that institutional investors have generally consistent but different specific methodologies and criteria for this assessment

Example: When 1,500 shares of restricted stock is granted as an alternative to a standard fixed price option grant of 5,000 options:

Supports Compensation Strategies	● The company would provide a form of compensation that likely has a higher probability of value to the employee; uses fewer shares; and even though requires an accounting expense under APB 25 would have a higher cost-benefit under FAS 123; and still uses no cash for the form of compensation
Viewed Positively by Employee	■ May be viewed positively as a full-value grant rather than option with no value at date of grant; but if conversation ratio (options-to-shares) is too low, may have the appearance of a "smaller" award
Low Cost per APB 25 (vs. alternative)	▲ APB 25 requires a fixed compensation expense for the 1,500 shares while the grant of 5,000 options would require no expense to be recognized under APB 25
Low Cost per FAS 123 (vs. alternative)	● FAS 123 requires a fixed compensation expense for the 1,500 shares and would also require a fixed compensation expense for the 5,000 options. The difference in accounting expense is much lower than under APB 25 and the cost-benefit ratio is improved as the restricted stock will almost always have some value to the employee, while the option may be worthless if stock price declines
Maximizes Tax Flexibility for the Employee	▲ For the restricted stock tax liability occurs at the vesting date the first of which is one year after grant; with options, the employee chooses when to be taxed because the tax liability occurs when the option is exercised, which may be as much as 10 years after grant
Helps Manage Dilution	● The restricted stock grant uses 70% fewer shares, significantly reducing dilution although the expense for the restricted stock may result in a greater net impact on EPS dilution than the stock option grant.
Positive for Investor Relations	■ Recently, investors have begun to take a more positive view of restricted stock, but their position will depend on how it is used; e.g., a replacement for options, (versus grants in addition to options), or use in lieu of cash awards

Where Do We Go from Here?

Of course, no one really knows what the future holds for stock-based compensation. Never have there been more sources of input on this topic. We now have compensation professionals, attorneys, accountants, investors and the media opining and influencing the design process. Certainly, compensation issues at the board of directors' level cannot be separated from other corporate governance concerns.

As highlighted in Figure 2 on page 47, finding the route that meets complex and often-conflicting objectives on a frequently changing map is a difficult task. Companies need to ensure that they have not only clarified the destination, but communicated the destination to all stakeholders — executives, employees, investors, media — to ensure the steps in the journey and the potential detours required to reach the destination are understood by all.

While we cannot predict the specific outcome of this situation, we do predict that all companies will need to devote significant resources to the study of this issue to ensure that future stock-based compensation practices both avoid the pitfalls of the past and take full advantage of the opportunities presented by this era of change. Not only do we have an opportunity to take a new route to our destination, we have an opportunity to draw the map. **WJ**

Webnotes

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Ward speaks frequently around the country, is quoted extensively, and has published writings on a variety of key compensation subjects. He was on the technical steering committee of the Coalition for American Equity Expansion, which successfully opposed rule changes proposed by the Financial Accounting Standards Board (FASB) for stock compensation plans. He testified at FASB's hearings on stock compensation accounting and participated in roundtable discussions aimed at resolving the stock option valuation dilemma posed by FASB's proposed standards. Ward is on the advisory board of the National Association of Stock Plan Professionals and teaches finance, accounting, and introductory and advanced courses in executive compensation for WorldatWork.

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Spotlight on Performance Management

Current Performance Management Practices

Examining the Varying Impacts



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Establishing an effective performance management system is a major challenge for most organizations. It has been a key topic in the human resources management literature for decades (Mohrman, Resnick-West and Lawler, 1989; Latham and Wexley, 1994). Recently, it has received a great deal of attention. Perhaps the most important reason for this interest is the increased importance of human capital. Because work requires more knowledge and skills, organizations depend more and more on the performance of their human capital, and as a result are increasingly focused on how it is managed.

It is very difficult to effectively manage human capital without a system that measures performance and performance capability. Organizations need a system that can identify the capabilities of its human capital so that they can effectively staff projects, implement strategic initiatives and manage the development of their workforces. They also need measures of performance so they can deal with performance problems and motivate performance excellence.