



# Thinking Strategically About Your Equity Compensation Program

Did you know most broad-based equity compensation programs were started by someone other than the person currently responsible for them?

In most cases, the founder is no longer at the company, the board of directors is not involved in the development of the program or the human resources department considers equity compensation programs “spending” programs rather than “talent” programs. Consequently, decisions regarding how much equity to grant are a result of:

- Benchmarking similar companies; or
- Responding to Institutional Shareholder Services pressures on the basis of how much to grant.

Neither approach includes a foundation based on solid research evidence, which often provides valuable insights into the decision-making process. Extensive research has identified three key learnings to help companies develop more comprehensive and robust compensation plans:

- Equity compensation must be integrated into your company’s strategy and story.
- Equity plans work best when part of a supportive culture.
- The context between base wages and a company’s equity plan matters most.

**The goal of this report is to share our key findings so you can think more strategically about your own equity compensation program.**

## Our Researchers

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from “The Citizen’s Share,”  
Yale University Press 2014.†

# The Research Evidence on Equity Compensation

Over the past 20 years, countless hours and millions of dollars have been spent on empirical research to determine how to structure equity compensation plans so they maximize results for both the employee and the organization. Many studies have been conducted to provide solutions on how to think more objectively about equity compensation.<sup>2</sup> A few of these studies are noted here:

## National Bureau of Economic Research

Funded by the Rockefeller Foundation and the Russell Sage Foundation,<sup>3</sup> the National Bureau of Economic Research (NBER) Shared Capitalism Study was a million-dollar joint study, conducted by Rutgers and Harvard, of more than 40,000 employees in 14 companies.

## U.S. General Social Survey

A similar study looked at a random sample of the entire U.S. adult working population. The U.S. General Social Survey (GSS) Study was funded mainly by U.S. tax dollars with support for the employee ownership questions from the Employee Ownership Foundation.<sup>3</sup>

## Best Places to Work

We also studied companies applying to the Great Place to Work Institute for participation in Fortune magazine's 100 Best Companies to Work For competition. This study, funded by the Alfred P. Sloan Foundation, looks at companies that make up 10% of total sales and employment, as well as 20% of the market value of the entire NYSE and NASDAQ.

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## Key Learning #1

# Equity Compensation Must Be Integrated Into Your Company's Strategy



**An equity compensation program that is well-designed, has executive support and shows measurable results often begins with an authentic story that fits with the company's overall strategy.**

Based on numerous interviews with company professionals, it was found that the key to developing an effective equity compensation program is an authentic story that aligns the program with the company's overall strategy.

If done well, your plan can ultimately drive the long-term goals of the company through highly engaged employees and a collective focus on achieving success.

**The best strategies include the following actions:**

**Encourage** company leaders to talk about the program in speeches and media interviews. Stress the importance and value of the program and link it to the company's core goals.

**Discuss** the program with your board of directors and help them understand how it supports the company's strategy.

**Describe** the program in SEC filings, such as the Proxy Statement and Annual Report. Explain how it fits into the company strategy, who participates in the program and why it is so important to the overall success of the company.

**Measure** the effectiveness of the program by including several dedicated questions in employee surveys.

**Include** a clear description of how the program fits with the company strategy and specific employee survey data on the effectiveness of the program if your company is having discussions with Institutional Shareholder Services or other proxy advisors about the program.

## Key Learning #2

# Equity Plans Work Best When Part of a Supportive Corporate Culture



**Over the past 20 years, a significant amount of time was spent sorting out how corporate culture can increase the probability that a broad-based equity share program will benefit both the shareholders and employees.** It was found that an equity plan is not merely an economic or “money” program. It can be a true value-added benefit if it is embedded within the organization’s culture.

**For this to happen, the corporate culture needs the following qualities:**

### Fair Wages

Employee wages must be at or above the market rate. Substituting an equity plan for competitive wages is the ultimate “cancel button” to a successful program. Our extensive national surveys, which featured the General Social Survey of all adult workers over multiple years, found that 72.8% of employees in equity plans reported they are paid wages at or above the market, while 28.4% reported they are paid below the market. You can use these statistics to benchmark your own employees.

### Employee Empowerment

In a flat management hierarchy, it is necessary to have a strong commitment to job- and department-level employee involvement, such as self-directed work teams. The studies showed these types of empowerment structures encourage employees to solve customer and company problems at the level of their job or department. This generates a sense of ownership and pride among the employee base.

### Supervision

The research found that employees excel when they are not tightly supervised. While this may seem counterintuitive, employees perform best when managers provide goals and the tools to achieve those goals and do not micromanage. Employees need managers with strong facilitation skills and who involve them in solving customer problems and give them the skills and training to do so. This does not mean performance reviews have no value. In fact, regular performance reviews are critical. They provide a structured forum to provide constructive feedback while tying an employee’s personal performance to the overall success of the company.

### Training

A strong commitment to training goes a long way. This specific research compared employees in equity programs in companies that provide a lot of informal and formal training with those that do not provide such opportunities. Findings showed that companies offering significant training programs had better outcomes for the corporations and individual employees.

### Job Security

The perception that employees in an equity program have job security over the coming year enhances the probability they are more committed to the company.



### Bringing It All Together

Equity plans thrive when they are part of supportive HR practices where employees:

- Believe they are paid fairly and can earn wealth beyond their base pay.
- Are given the tools and training to address customer and company problems.
- Are provided clear performance goals on which they receive ongoing feedback and evaluation.
- Believe they will be around long enough to make a difference.

This research is very consistent with what is now called Strategic Human Resource Management or High Performance Work Systems. This finding states that a company will have better measurable outcomes for employees when implementing a broad-based share plan.

## Key Learning #3

# Wage Context Matters Most



**When employees report their wages are below market, virtually all intrinsic benefits of an equity compensation program are cancelled out. This includes employee motivation, employee satisfaction and employee commitment.<sup>4</sup> This concept in economics is called “wage substitution.” It occurs when companies do not want to pay a fair-market wage and instead challenge the employee to make up for the gap by participating in an equity compensation or profit-sharing plan.**

Research found that employees and companies benefit from equity compensation plans when there is an opportunity to earn wealth on top of a fair-market wage.

Most U.S. employees report they prefer to have some wage increases come from a capital share plan, such as an equity compensation program. This is contrary to what we often hear at equity compensation conferences. Comments such as “my boss believes employees want cash in pocket” or “my millennials want cash” have no academic evidence.

Why do most employees want some type of capital shares? Because over the last 25 years, real wages have increased, on average, about 1–2% a year, while the long-term real return of equities for over a century has been in the 4–6% range, conservatively speaking.<sup>5</sup> Employees seek opportunities to earn more over the long term.

This is also true for those who are averse to stock market risk. The study divided employees into two groups: those who measured high in risk tolerance and those who measured low. Surprisingly, two-thirds of the risk-averse employees we surveyed wanted equity as part of their future compensation.

So why do we hear these quotes about employees preferring cash? It may be that many of these remarks are from people who are misinformed, simply generalizing or seeking a reason to cancel or limit participation in an equity compensation program. Impressions, biases or beliefs without scientific basis are not a good foundation for designing an equity compensation program.

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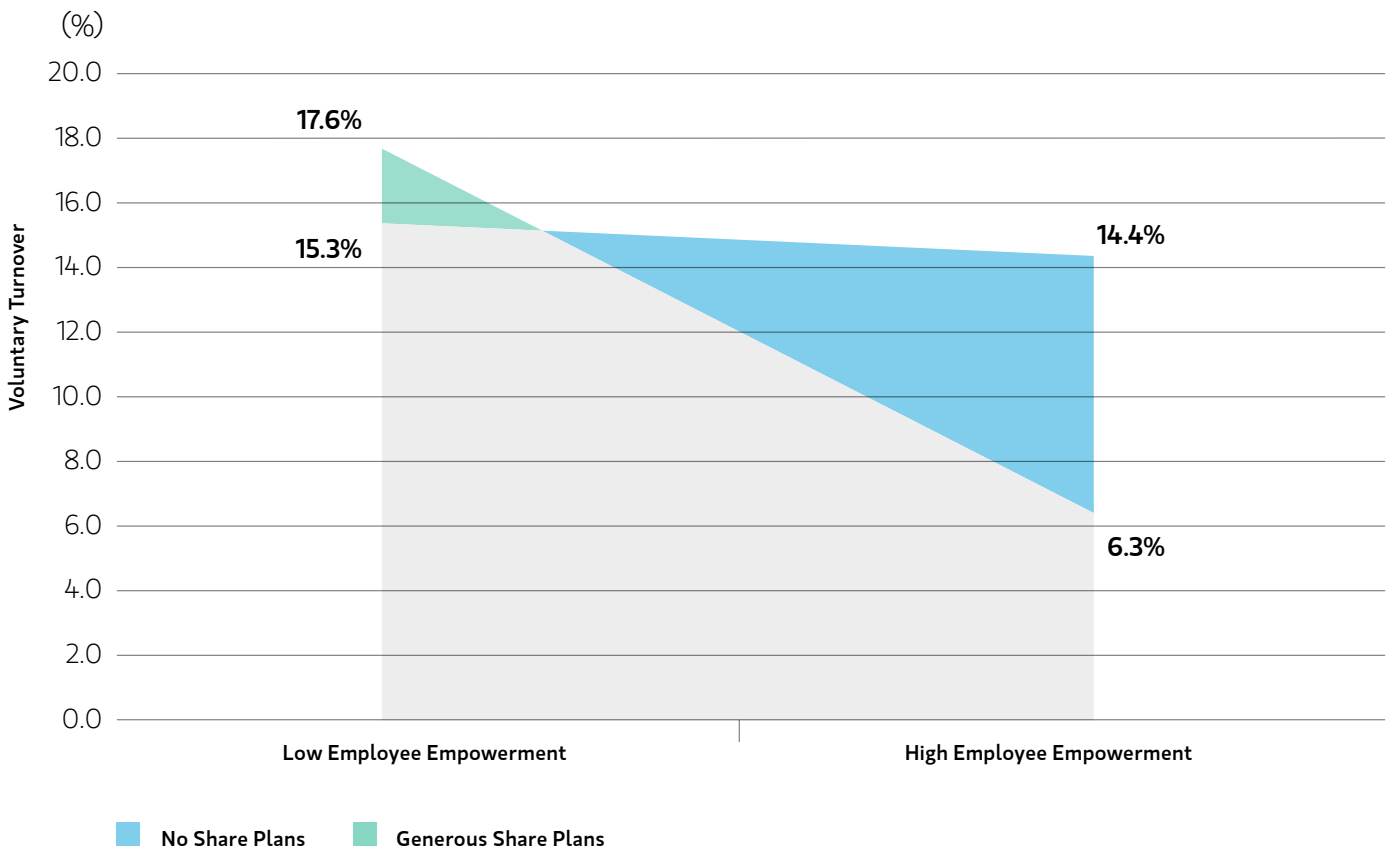
## How Big is the Impact?

**The impact on your company can be meaningful. This chart highlights the relationship between equity compensation plans and employee turnover.\***

The left side of the chart shows companies with low employee empowerment, while the right side shows companies with high employee empowerment. The blue line represents companies with no significant equity program, while the green line focuses on companies with generous programs.

As you can see, companies that combined high employee empowerment with equity programs showed an average voluntary employee turnover of 6.3%, compared to companies that had low employee empowerment and no programs, which had an average turnover of 15.3%. Companies that had plans without employee empowerment had the highest turnover rate of 17.6%, illustrating that an equity compensation plan without a supportive corporate culture was unable to hold employees at the firm.<sup>5</sup>

### Share Plans, Employee Empowerment and Turnover



\*The results are based on data from the approximately 800 companies that applied for the Best Companies to Work For contest by Fortune magazine and had employee and management surveys done by the Great Place to Work Institute from 2005-2007. Of those, just 100 companies win the Hundred Best Companies designation each year.



When designing an effective equity compensation plan, it's important to collect, review and share existing research studies with the key decision makers within your firm. This includes top executives and board members, as well as proxy advisor firms. It's also important to conduct your own primary research with employees through surveys and other outreach programs.

Proper research will help you develop a tailored plan that aligns your employees' total compensation package with your company's corporate culture and your long-term strategy for success. Benefits of an integrated equity plan include higher employee satisfaction, engagement and retention rates.

## Meet Our Researchers



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Joseph R. Blasi, an economic sociologist, is the J. Robert Beyster Distinguished Professor at the Rutgers University School of Management and Labor Relations. Professor Blasi is Director of Rutgers' Institute for the Study of Employee Ownership and Profit Sharing. He has a doctorate from Harvard University's School of Education and is a Research Associate of the National Bureau of Economic Research and a Research Fellow of the Institute for the Study of Labor in Bonn, Germany.

Professor Blasi has appeared on CNN, Fox Business, CNBC, MSNBC, NPR and many public radio stations nationwide. He is regularly called upon to advise presidential administrations, presidential candidates, members of Congress and major philanthropic foundations. He has been a regular commentator for the Huffington Post and Fortune magazine and has had op-ed essays appear in The New York Times, Time and the Los Angeles Times. He is the author of 15 books and many academic articles. His most recent books are "The Citizen's Share: Reducing Inequality in the 21st Century" (Yale University Press) and "Shared Capitalism at Work" (University of Chicago Press).

Professor Blasi regularly updates the professional world on equity compensation and related issues on his Twitter feed @JosephBlasi. For the website of the Institute for the Study of Employee Ownership and Profit Sharing, please visit <https://smlr.rutgers.edu/content/institute-study-employee-ownership-and-profit-sharing>.



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Dr. Bill Castellano is Chair of the Human Resource Management department and Professor of Strategic HR Management at Rutgers University School of Management and Labor Relations. He is the former Associate Dean of External Engagement and Executive and Professional Education and was the former Director of the Center for HR Strategy.

Dr. Castellano's research, teachings and consulting activities are focused on the effective management of human capital, employee engagement and developing leaders for the challenges of the 21st century. He has over 30 years of experience working in corporate Fortune 50, entrepreneurial and research environments.

Before joining Rutgers University, Dr. Castellano was a Managing Partner at an executive search firm and a Chief Marketing Officer at a national HR outsourcing company. He also held senior HR management positions at Merrill Lynch and Manufacturers Hanover Trust, where he was involved with human resource strategies and practices that supported both individual business groups and the global enterprise.

Dr. Castellano is an accomplished researcher, publishing his work in practitioner and academic journals and is a frequent speaker at national HR and business conferences.



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Douglas Kruse is a Distinguished Professor in the School of Management and Labor Relations at Rutgers University, a Research Associate at the National Bureau of Economic Research (Cambridge, MA) and a Research Fellow at the IZA Institute for the Study of Labor (Bonn, Germany).

Dr. Kruse served as Senior Economist at the White House Council of Economic Advisers from 2013–2014. He received an M.A. in Economics from the University of Nebraska-Lincoln and a Ph.D. in Economics from Harvard University. His research has focused on the employment and earnings effects of disability and the causes, consequences and implications of employee ownership and profit sharing.

His most recent co-authored books are "How Did Employee Ownership Firms Weather the Past Two Recessions?" (W.E. Upjohn Institute Press), "The Citizen's Share: Reducing Inequality in the 21st Century" (Yale University Press), "People with Disabilities: Sidelined or Mainstreamed?" (Cambridge University Press) and "Shared Capitalism at Work" (University of Chicago Press). His book "Profit Sharing: Does It Make A Difference?" won Princeton University's Richard A. Lester prize as the year's "Outstanding Book" in Labor Economics and Industrial Relations.

Dr. Kruse has also published widely in peer-reviewed journals and is an editor of the British Journal of Industrial Relations. He has testified four times before Congress on his economic research, authored or co-authored three U.S. Department of Labor Studies and served on the President's Committee on Employment of People with Disabilities and New Jersey's State Rehabilitation Council.

This material was published on [date] and is subject to change without notice.

<sup>1</sup> We co-authored this book with Professor Richard Freeman of Harvard University. It is available at online booksellers in paper and electronic versions. Chapter 5 is a longer summary of the research discussed in this report.

<sup>2</sup> The results were published in a book, "Shared Capitalism at Work," written by D. Kruse, R. Freeman and J. Blasi and published by the University of Chicago Press in 2010.

<sup>3</sup> The Employee Ownership Foundation supports the data collection of the General Social Survey through a separate contract with the National Opinion Research Center of the University of Chicago that independently administers the survey on contract with the U.S. Government's National Science Foundation. A national random sample of 1,000-2,000 adult employees is surveyed every two years in person at their homes. The data collected represents a national random representative sample of the entire U.S. working population. Professors Blasi and Kruse analyze the data on a volunteer basis. To see the results of the 2014 General Social Survey for share plans, see the site of the National Center for Employee Ownership at [www.nber.org](http://www.nber.org) at <https://www.nceo.org/articles/widespread-employee-ownership-us>.

<sup>4</sup> The question we have used in our employee surveys is: Do you believe that your fixed annual wages in 2004 were higher or lower than those of employees with similar experience and job descriptions in other companies in your region? Please circle a number from 1 to 5. Lower Higher 1 2 3 4 5 —% higher —% lower.

<sup>5</sup> Source: <https://www.pragcap.com/u-s-equities-long-term-real-returns/>.

<sup>6</sup> The full survey is available at the National Bureau for Economic Research website: <http://www.nber.org/papers/w17745> or in the British Journal of Industrial Relations at <http://onlinelibrary.wiley.com/doi/10.1111/bjir.12135/full>.

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