

RESEARCH BRIEF

Human Resource Management Department



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For Effective Equity Compensation Programs, Think Strategically

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Who's managing your broad-based equity compensation? In most firms, it's not the person who started the program. Usually, the founder is no longer at the company; the board of directors is not involved; and the human resources department does not understand that it's really a talent program, not a spending program. As a result, most firms decide how much equity to grant by copying their competitors or considering the views of Institutional Shareholder Services. Neither approach is based on solid research evidence. This article summarizes the latest empirical research to help your company develop a comprehensive and robust equity compensation plan.

At the Rutgers School of Management and Labor Relations, Department of Human Resource Management, we have been studying equity compensation for more than 20 years.

Our latest projects, at right, provide especially useful insights for companies that want to think objectively about their program.

This empirical research can help you design an equity compensation plan that maximizes results for both the employees and the organization.

3 Major Research Projects

- 1. Shared Capitalism Study:** Conducted by Rutgers and Harvard, this research study analyzed data from more than 40,000 employees in 14 companies.
- 2. U.S. General Social Survey (GSS):** In partnership with the Employee Ownership Foundation, we developed several questions for a government survey of employed adults.
- 3. Best Places to Work:** This Rutgers analysis looked at data from *Fortune's* "100 Best Companies to Work For" competition.

WHAT THE RESEARCH SHOWS

KEY LESSON #1: Build the Program on an Authentic Narrative That Fits the Company Strategy

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

- **Company leaders talk about the program in speeches and media interviews.** Leaders should stress the importance and value of the program and link it to the company's core goals.
- **Get the Board on board.** 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.** When preparing documents such as the Proxy Statement and Annual Report, explain *how* equity compensation fits into the company strategy, *who* participates in the program, and *why* it is so important to the overall success of the company.
- **Measure effectiveness.** In addition to considering economic indicators of program effectiveness, learn how employees view it by including several dedicated questions in employee surveys.

KEY LESSON #2: Equity Plans Work Best When Part of a Supportive Corporate Culture

For the last two decades, we have spent significant time sorting out how corporate culture can make broad-based equity compensation programs more beneficial to both the shareholders and the employees. What we found is 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.** Substituting equity compensation for competitive wages is the ultimate “cancel button” to a successful program. Employee wages *must* be at or above the market rate. 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. We found 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.** Our 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 these goals and do not micromanage. Facilitation skills are important. Employees need managers who involve them in solving customer problems and give them the skills and training to do so.
- **Feedback.** This does not mean performance reviews have no value. In fact, regular performance reviews are critical. They provide a structured forum to give 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. Our 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. We found 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.

A Supportive Culture for Equity Compensation

1. **Fairness:** Employees feel they are paid fairly and can earn wealth beyond their base pay.
2. **Empowerment:** Employees are given the tools and training to address customer and company problems.
3. **Clarity:** Employees receive clear performance goals with ongoing feedback and evaluation.
4. **Security:** Employees believe they will stay with the company long enough to make a difference.

KEY LESSON #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. 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 earn the gap by participating in an equity compensation or profit-sharing plan.

Our 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. “My boss believes employees want cash in pocket” and “My millennials want cash” have no academic evidence.

Impressions, biases, and beliefs without scientific basis are not a good foundation for designing an equity compensation program.

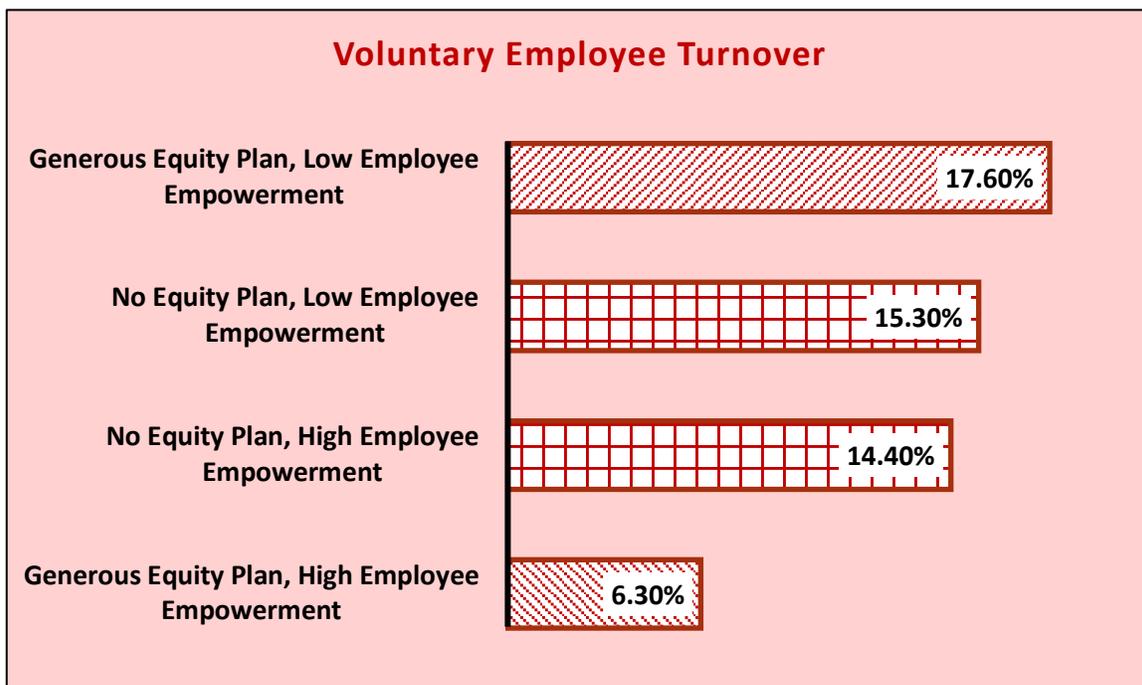
Why do most employees want capital shares?

Real wages have increased, on average, about 1-2% a year over the last 25 years, while the long-term real return of equities has been in the 7% range, conservatively speaking, for the last fifty years. Employees seek opportunities to earn more over the long term. This is also true for those who are averse to stock market risk. Our 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 wanted equity as part of their future compensation.

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

HOW BIG IS THE IMPACT?

The impact of effective equity compensation can be substantial. In one analysis, we looked at data provided by the approximately 800 companies that applied for Fortune’s “100 Best Companies to Work For” competition, combined with employee and management responses to questions in a survey by the Great Place to Work Institute. This chart highlights the relationship between equity compensation plans and employee turnover.



Companies that offer a generous equity compensation plan, but do not empower their employees, showed a higher voluntary turnover rate (17.5%) than firms with no equity plan. By contrast, companies that combined a generous plan with employee empowerment had the lowest turnover rate (6.3%). This illustrates the importance of pairing your equity compensation program with a supportive corporate culture.

PRACTICAL IMPLICATIONS

When designing an effective equity compensation program, it's important to collect, review, share, and apply existing research findings. Key decision makers should include top executives, board members, and proxy advisors. Instead of letting pre-conceived ideas and biases drive decision making, it's important to conduct primary research with employee surveys and other outreach programs. This research can provide a strong foundation for developing a plan that aligns your total compensation package with the company's corporate culture and long-term strategy for success.

A successful equity compensation program that's integrated with other HR practices as well as your company's unique corporate culture can lead to higher employee satisfaction, greater employee engagement, and better talent retention.

Suggestions for Further Reading

1. *"Thinking Strategically About Your Equity Compensation Program"* a report by **Joseph R. Blasi, Douglas L. Kruse, & Bill Castellano**, published by Morgan Stanley Smith Barney LLC, 2018. Used here with permission.
2. *Shared Capitalism at Work*, a book by **Douglas Kruse, Richard B. Freeman, & Joseph R. Blasi**, published by the University of Chicago Press, 2010.
3. "How an Employee Stock Ownership Plan (ESOP) Works," published by the National Center for Employee Ownership and available at <https://www.nceo.org/articles/esop-employee-stock-ownership-plan>
4. *The Citizen's Share: Reducing Inequality in the 21st Century*, a book by **Joseph R. Blasi, Richard B. Freeman, & Douglas L. Kruse**, 2014.
5. The Global Equity Organization, an association of multi-national corporations, many of whom offer broad-based equity compensation plans, is a useful resource at: www.globalequity.org
6. The Institute for the Study of Employee Ownership and Profit Sharing at the Rutgers School of Management and Labor Relations sponsors empirical research, academic fellowships, and scholarly conferences on broad-based equity compensation. Learn more at: <https://smlr.rutgers.edu/content/institute-study-employee-ownership-and-profit-sharing>