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# Stock Option Compensation: Strategies for Employee Payment and Retention

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As organizations continue to navigate the many uncertainties the COVID-19 pandemic has thrusted upon them, one near-universal goal is cash conservation. Whether an organization adjusts their business model in some capacity, reduces headcount, or cuts budgets a set percentage across the board, it will be critical for growth to plan for how key employees will be incentivized and compensated now and once operations return to normal.

Given the need for short term cash conservation, countered by the long run impacts of potential salary reductions, business executives and boards weathering economic disruptions may find it a compelling time to consider stock option compensation, or other equity-based compensation, as a viable action to conserve cash while retaining key talent and aligning incentives for the longer term.

While a growing number of businesses use equity compensation for their key employees, many companies do not. For those executives considering doing so, there are a variety of plans available.

### Stock Option Compensation Options

- Employee Stock Ownership Plans (ESOPs)
  - A retirement plan, similar to a 401(k), which invests mostly in company stock and holds its assets in a trust for employees. The participants accrue shares over time and they receive a pay out when their shares are bought back.
  - According to the National Center for Employee Ownership (NEOC), approximately 6,500 U.S. companies have this type of plan, and approximately 14 million U.S. workers are participants.
  - Added advantage in having employees participate as “owners” in times of turmoil.
  - Creates a “we are all in this together” mentality and ensuing culture.
- Equity Compensation Plans
  - Grants of stock or stock equivalents from an employer to their employees (e.g., stock options, restricted stock, phantom stock, performance shares, direct grants, etc.).
- Worker Co-operatives
  - Companies that are owned and operated by their workers. This is more common internationally than in the U.S.
  - Again, a culture builder.
- 401(k) Plans
  - Employers offer company stock as an investment alternative or as a company match to its employees. These are sometimes combined with an ESOP and referred to as a KSOP.
  - Millions of workers participate in these plans.

For the organization currently offering equity compensation through stock option plans, the value of underlying stock has likely decreased in the last several months and the results of COVID-19 have had a material impact on the valuations of many privately-held companies.

While this impact is certainly a challenge for owners, investors, management and employees, a small silver lining of improved entry points for forward-equity ownership for key people may be available, as an organization could offer additional equity compensation via any of the plans mentioned above.

This approach enables owner-investor-key employee alignment while, again, helping to minimize the short term cash outlays and still providing significant incentive to the key people. Having cash on hand during an economic slowdown critical, as is the retention of the key people who will enable the resumption of growth when the pandemic impacts subside.

While no one could have prepared for the rapidly changing nature of the pandemic we find ourselves in, it has shown the importance of cash flow planning for businesses in the coming months to weather the storm. As addressed in our recent survey of

West Coast Businesses and “What’s Next? Life Beyond COVID-19” webinar, executives need to plan now for June-September by building a basic cash flow forecast to understand what may work for them and what may not.

If an organization has pool remaining, they may also decide to issue new and/or replacement employee stock options as a way to offset cash compensation adjustments and maximize alignment and morale among key employees.

As we look towards the future, when the economy thaws and business ramps up again, granting equity to employees remains an important strategy for retaining talent. Businesses that must make tough decisions to cut salaries and/or headcount numbers might find that countering those tough decisions with new grants will provide a strong impetus for relative success both in terms of short-run morale and long-run key people retention and future recruitment.

Offering additional equity and incentive stock options certainly would help circumvent a potential exodus from important players and hopefully dissuade job searching. By providing a goodwill act now, amid other cuts and aligning incentives, owners and investors will be potentially laying the groundwork for a big picture winning strategy. It certainly has the potential to be a win-win for business owners during the current challenges, as well as the long run resumption of normal.

Contact BPM’s Kemp Moyer or Jill Pappenheimer to learn more about how your organization can benefit from stock option compensation options in the future.