BUSINESS PERFORMANCE ADVANTAGE

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Golden Handcuffs – New Executive Perks On the Rise

You have inevitably heard of them by name. They were legends in their own time – the golden barons of corporate America. Their names are Kenneth Lay, Bernard Ebbers and Jack Welch – the former CEO's of Enron, WorldCom, and General Electric respectively. These three sovereigns of Wall Street were so highly regarded by their respective enterprises that they seemed irreplaceable. o, what exactly could the stakeholders do to keep these golden barons in place? Offer them more gold, of course! How about a pair of golden handcuffs?

Wondering what golden handcuffs are? It will not surprise you to learn that the term "golden handcuffs" is yet another buzz word from corporate America. It refers to supplementary executive perks that are structured to attract and keep top performers and other key personnel. Stock options, deferred compensation and low interest loans are examples of some of the perks that have served as golden handcuffs. However, these perks are only effective as golden handcuffs if they contain forfeiture provisions that require continued employment and/or include non-compete agreements.

How were golden handcuffs applied to the three golden barons? Kenneth Lay was clandestinely awarded a 7.5 million dollar line of credit that could be repaid with stock that Enron had given him. He built a 'house-of-cards' and it imploded! Bernard Ebbers mysteriously received more than $400 million in personal loans, with very soft repayment terms. WorldCom has since filed for the world's largest bankruptcy! General Electric secretly spent $15 million on a penthouse for Jack Welch. He had to give it back! After these incidents, and others, the Sarbanes-Oxley Act of 2002 was introduced.

The Sarbanes-Oxley Act of 2002 was enacted following several corporate scandals similar to the three portrayed above. This law makes it incumbent on corporate America to establish a system of corporate governance and internal controls based on the highest ethical principles and standards. Among its many provisions, it specifically requires detailed disclosures of off-balance-sheet transactions and bans company loans to officers and directors. This law, in effect, put a stop to a growing corporate trend of ever-richer executive benefits packages whose costs were not disclosed to shareholders. Corporate America still uses the golden handcuff principle, with full shareholder disclosure, to attract and keep top performers and other key personnel.

Most companies now take a proactive approach in the use of golden handcuffs to retain their most talented personnel. The practice of offering cash bonuses or similar perks based on meeting certain performance standards can be effective; however, once these awards are granted, they have no lasting value when it comes to ensuring the individual's continued performance, loyalty and/or stability. The golden handcuff approach provides added incentive for the individual to stick-around. These perks may come in the form of a retention bonus that is cleverly coupled with a repayment and non-compete agreement. If the individual leaves, the company then has the right to partial or even full repayment. In some cases, retention bonuses are used to provide the employee with cash for a home mortgage down payment. These agreements usually provide the company with the right to place lien on the individual's personal residence. Probably the most effective golden handcuffs are those that provide the individual with some form of equity in the business.

"Equity is the bonus that keeps on giving," according to Paul Lemberg of the Stratamax Research Institute. "The value of equity compensation is likely to increase over time, often considerably. Equity acknowledges your employee's past contribution, but the real payoff is for work still to be done – and your people have to stay around to reap the rewards. In real

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terms, the current cost of equity compensation is cheap, especially relative to the loyalty it can purchase. Plus, since no cash changes hands at the time of the equity bonus, you can use it as a reward even if your company is cash-strapped." Equity compensation might include outright stock grants, non-qualified stock options or phantom stock. Such equity grants will not be effective as golden handcuffs unless they are coupled with a defined vesting period.

In today's economy, successful companies need to offer ample perks and benefits to attract and retain top-notch executives and employees. These perks need to be tied to the company's future performance in order to assure that key personnel will stay-the-course to reap the long term payback. Benefits tied to equity in the company appear to be most effective golden handcuffs available. To learn more about establishing employee incentives and managing peak performance, call us today.