How private companies can manage equity compensation effectively

Share incentive plans are becoming more and more popular among private companies as a means of remunerating employees and improving staff retention. Increasingly, these organisations are looking to implement share-based remuneration that extends beyond the executive pool. Private companies offering incentive plans must carefully navigate a maze of complexities related to their incentive plan administration, accounting, and communication – even more so than their listed counterparts. If these are not managed effectively, there can be adverse effects for both the company and the employees it is looking to remunerate and retain.

Incentives that work

In recent years, private companies have moved away from phantom share plans, which pay out the equivalent cash value of an equity incentive when they vest, to rewarding staff with a share in the company. Share incentives have emerged as a desirable option for companies looking to keep their cash flow steady while allowing employees the chance to reap long-term benefits from their employment and business growth. The opportunity to partake in long-term company growth has become a popular choice amongst employees who are opting to retain their shares rather than cash out when these incentives vest, displaying an enthusiasm to become part of something more significant.

Several factors play a pivotal role in ensuring a successful incentive plan, among them being the requirement for clear and ongoing communication of the plan with employees. When an incentive plan is not well understood by employees, it is likely to have its value eroded by competing interests or other factors that adversely affect loyalty — such as changes in management or corporate strategy — and its effectiveness as an incentive tool can diminish.

Communicating the value

For private companies, effective communication with share plan participants is even more important due to the lack of publicly available financial information, such as readily available share price information or news on corporate actions. Unlike listed companies, private company shares are not traded on an open market, making it difficult for shareholders to easily understand the value of their equity and, consequently, the value of equity incentives. Therefore, this value must be communicated to participants to maximise the incentives' efficacy and keep them abreast of any corporate news – such as plans to list or possible liquidity events.

Fair valuing incentive plans can be a tricky task, but attempting to estimate the value without proper guidance could not only prove costly – but it may also work against staff retention. Fortunately, technology is on hand to support and automate these complex computations – saving time and money while also providing transparency into how successful each initiative truly is in driving engagement and retaining valued staff members.

Managing the reward lifecycle from issuance to settlement

For private companies, the administration of equity compensation provides a unique set of complex challenges. Awarding and tracking these awards is only part of it – settling them in an environment where liquidity issues will most likely arise makes it all the more difficult. For example, employees may not be able to sell a portion of their equity until the company goes public or undergoes a liquidity event.

Therefore, planning couldn't be more important when launching an equity-based incentive plan. Companies must carefully consider the implications of enabling their incentive plan participants to sell their equity while considering liquidity constraints and incentive-related taxes, as well as how best to ensure funds are transferred securely into participants' bank accounts. These decisions will have a significant financial effect on employees, requiring thoughtful attention from all parties involved.

Working with the right technology partner can bring immense value in tackling complex incentive plan challenges. It can personalise communication and create customised processes such as online award issue flows with digital signing capabilities that enable electronic tracking of orders from start to finish. Furthermore, tax calculations and payment automation through specialised incentive technology can facilitate a more streamlined, communicative experience that everyone can rely on.

Managing the share register

Ensuring adequate tracking of equity ownership is critical in understanding the influence that share dilutions can have on current shareholders and potential investors alike. A highly-intelligent, automated system prevents any unnecessary complexity associated with managing a share register, specifically during liquidity or capital events. With an appropriate technology solution, companies can store all pertinent documentation related to both shareholdings and dividends on one central repository (often referred to as a "Cap Table"), allowing it not only to facilitate future investments but also to execute dilution scenarios for adequate funding management.

Simplifying the complexity

Consideration of administration, remuneration and compliance reporting is vital in maintaining cost-effective yet compliant incentive plans. Accounting for equity-settled or phantom plans must also be achieved in line with the financial reporting standards on share-based transactions. Keeping up with all these areas can be simplified through automated processes.

Automated integration can reduce risk and simplify complex processes using step-by-step procedures, making calculations easier and providing the necessary monitoring and recordkeeping to ensure efficient administration across the organisation.

By implementing a digital tool, businesses can instil order in their operations. Employees are kept in the loop, and a culture of ownership is established, which in turn drives greater employee engagement and retention.