

Saratoga  
Human resource services

# The Saratoga Review

Newsletter Issue: February/March 2010

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# What's happening at PwC Saratoga

The key activities coming up at PwC Saratoga include:

- **March 31, 2010:** Data entry deadline for the health insurer, hospital, insurance, and utility benchmarking consortiums and US Human Capital Effectiveness Surveys.
- **April 15, 2010:** PwC Saratoga will launch its *Latin American* survey. This year's survey will consist of approximately 50 metrics and will cover South and Central America as well as Mexico. To learn more, please contact **Jon Burton** at [jon.burton@saratoga.pwc.com](mailto:jon.burton@saratoga.pwc.com); (408) 817-7440.
- **April 12, 2010:** PwC Saratoga Metrics 101 course will be held in McLean, Virginia. Additionally, PwC Saratoga will host its first Metrics 200 course on April 21, 2010. The Metrics 200 course will still be part of our foundational metrics series but will have a deeper focus on dashboard development, data analysis, and use of metrics to build business cases. To register for either course, please copy and paste the following URL into your Web browser—[www.meetpwc.com/saratogametric101](http://www.meetpwc.com/saratogametric101). The next Metrics 101 course will be held in Dallas on June 16. The next Metrics 200 course will be held in New York City on September 15.
- **Early June 2010:** PwC Saratoga will release the 2010/2011 US Human Capital Effectiveness Report.

To learn more about any of these activities, please see page 11 of this newsletter for the contact information of your local Saratoga representative or call 1-866-727-2864.

# Refining the pay-for-performance model

The following article is a summary of a recent publication by PwC called **“10Minutes on compensation—refining the pay-for-performance model.”** To view the full article, please [click here](#).

Today’s pay-for-performance model has come under increasing scrutiny from US policymakers and their global counterparts. The collective goal is to ensure that compensation packages at all public companies—not just banks and financial services institutions—don’t put the long-term health of businesses and the overall economy at undue risk.

To this end, US lawmakers and regulators are looking to lessen the degree to which companies emphasize short-term performance. They also want greater disclosure about how public companies’ compensation policies might precipitate events that businesses don’t have the financial wherewithal to withstand. Various new pieces of federal guidance will force companies across all sectors to take a much broader view of both performance and risk. A highlight of what is and isn’t included in this new guidance appears below.

What the new guidance does	What it doesn’t do
<ul style="list-style-type: none"><li>• Emphasize stronger governance and analysis of the risk-compensation relationship</li><li>• Expand beyond the C-suite the employee compensation policies that should be reviewed and possibly disclosed</li><li>• Require proxy statement disclosure of how risk is overseen by the board and managed by senior officers</li><li>• Require companies to report equity compensation at fair value</li></ul>	<ul style="list-style-type: none"><li>• Set limits on compensation (except for TARP recipients that haven’t repaid the government)</li><li>• Require boards to expand their direct oversight of compensation programs beyond those for top officers</li><li>• Call for additional disclosures in the Compensation Discussion and Analysis section of proxy statements</li><li>• Necessitate significant changes in compensation structures and policies at many companies</li></ul>

Companies that approach this as an opportunity, rather than just a compliance exercise, can derive long-term benefits from the evolution of the pay-for-performance model.

What this means for companies:

1. Companies will need to demonstrate that their compensation models are layering in risk considerations and long-term corporate stability to a much greater degree than before.
2. Boards will have to assess the compensation policies for any employee who, by virtue of his or her corporate function, could put the business at heightened risk.
3. Companies may need to consider putting compensation “at risk” for longer periods so that the timing of incentive pay and performance is not misaligned.
4. Putting compensation at risk for longer periods may pose challenges for companies in light of recent tax rule changes.
5. Greater disclosure about risk and reward may inform shareholder views/votes on compensation decisions.

To have a deeper discussion about compensation, please contact: Scott Olsen at 646-471-0651; [scott.n.olsen@us.pwc.com](mailto:scott.n.olsen@us.pwc.com)

# Global Equity Incentives Survey summary

The following article is a summary of a recent publication by PwC called “Leading the rebound: Equity compensation in the spotlight.” To view the full article, please [click here](#).

Today, executive compensation is under heightened scrutiny. Sentiment regarding executive compensation policies and practices is volatile, resulting in increased pressure on executive compensation to conform to the new—and sometimes conflicting—sets of principles emerging from a broad group of shareholders, regulators, and other stakeholders. In light of this, organizations continue to rely on equity compensation as a critical mechanism for linking executive interest with shareholder and broader economic value.

Any discussion about the global economic downturn will ultimately reflect upon the downturn’s depth and the relative lack of immunity in many organizations, particularly those that were beneficiaries of government intervention or subjected to increased regulations. Regulators, in particular, have examined the downturn and are focusing on the performance of key employees and executive management teams as part of a search for ways to help prevent similar market results in the future. The emergence of their influence, on top of continued shareholder attention, focuses on refining the pay-for-performance model to account for risk and sustainability.

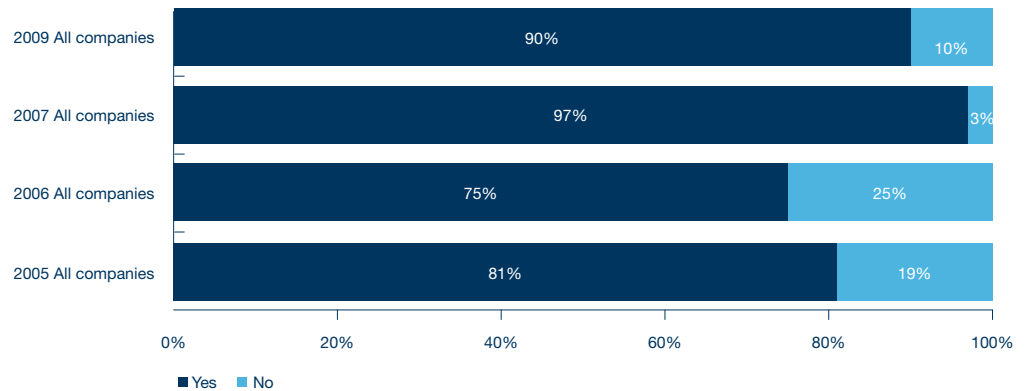
PricewaterhouseCoopers’ sixth *Global Equity Incentives Survey* is one of the most comprehensive studies of international equity and incentive plans, covering design, expensing and budgeting, global coordination, compliance and tax planning, process and administration, and communications. A total of 340 multinationals participated in the survey between January and April 2009. This summary focuses on the following themes:

- Implications of the market downturn on compensation
- Anticipated changes in CEO compensation
- Underwater stock options
- Equity compensation mix
- Emerging markets
- IFRS compliance and convergence
- Tax compliance

An overview of each of these key themes appears on the following pages.

## Implications of the market downturn on compensation

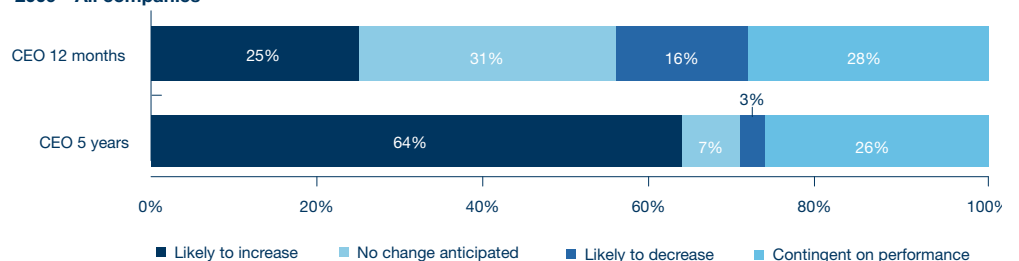
The public debate over executive compensation payouts may continue, but the role of equity compensation as a critical tool for linking executive performance to corporate strategic objectives remains arguably more important than ever. PricewaterhouseCoopers' 2009 Global Equity Incentives Survey reveals trends and practices in executive compensation that are fluid in these turbulent times and indicative of where future practices may lead. Although the context is very different from last year's survey, we believe the most telling survey result is the same as it was last year in answer to this question: Do the benefits of maintaining an equity compensation plan outweigh the cost? As noted in the chart below, after consideration of the past year's events—such as stock price volatility, accounting compliance issues, and increased shareholder activism—the resounding answer to this question is yes, there is tremendous value in properly designed and administered equity compensation plans.



## Anticipated changes in CEO compensation

The impact of economic and market downturns, in conjunction with a heightened shareholder and regulatory environment, has had a predictable impact on CEO compensation. The 2009 survey results indicate that nearly half of the participants believe either that CEO pay will not change or that CEO pay will decrease in the short term. For the long term, however, most companies are optimistic, with nearly two-thirds of participants reporting that CEO pay will increase over the next five years.

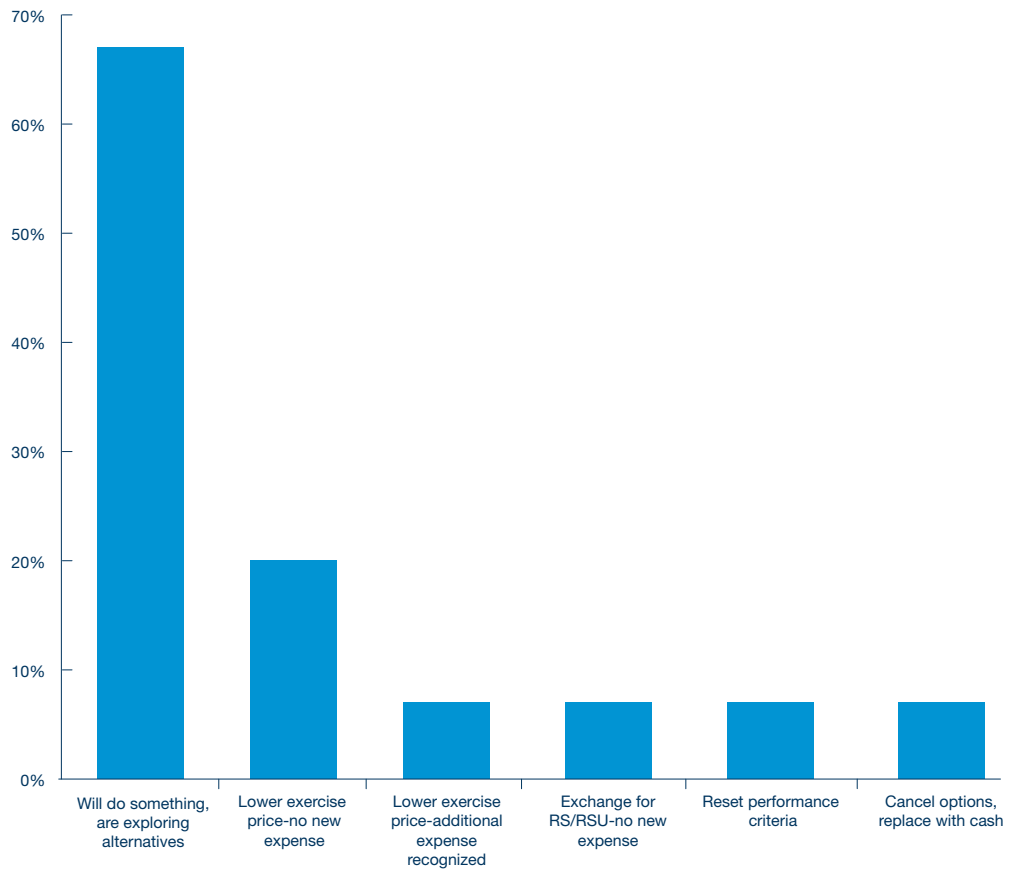
**Anticipated changes in CEO compensation  
2009—All companies**



## Underwater stock options

The recent market downturn has led to a significant number of outstanding, underwater stock options. In the 2009 survey, 80 percent of respondents reported that they are making changes to outstanding grants based on current market conditions. As noted below, the majority of organizations had not finalized their plans to address outstanding equity compensation grants.

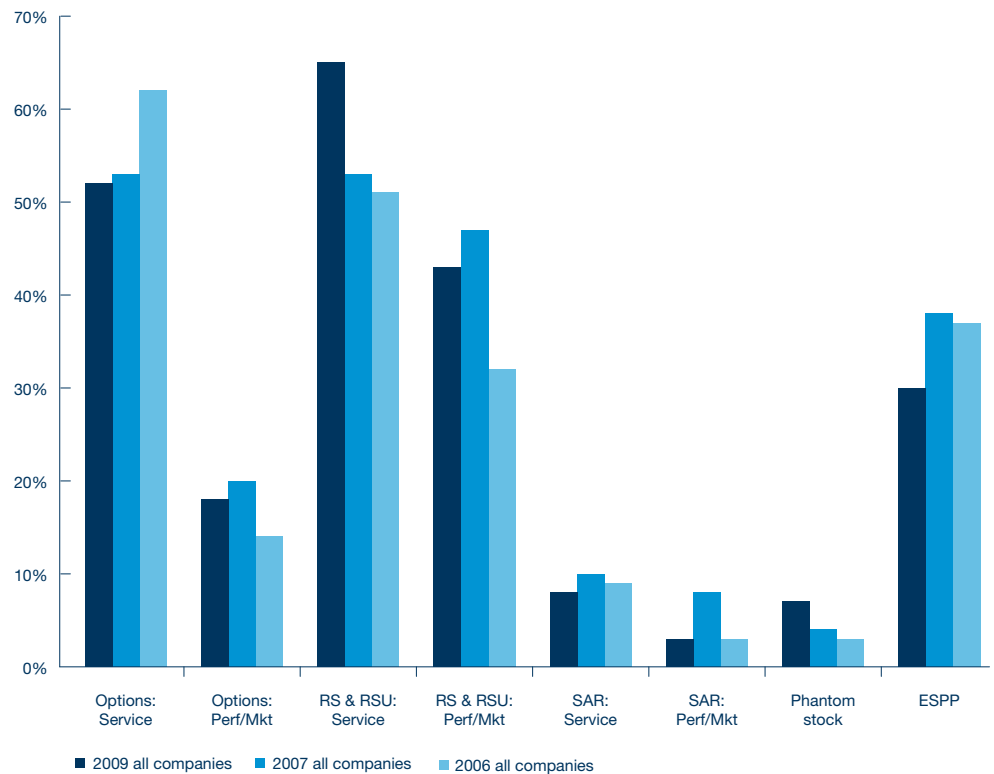
**What changes will be made to outstanding equity compensation grants?**



## Equity compensation mix

Responses to the 2007 Global Equity Incentives Survey indicated an increase in the prevalence of performance-based stock equity. However, that trend apparently lost a little momentum in 2009 as companies increased their use of service RS/RSUs—likely because of the uncertainty around near-term economic performance. The latter trend may also reflect companies’ goals to motivate and retain critical or pivotal talent in spite of declining market prices, and it may prove to be a short-term strategy for bridging to the market turnaround and ensuring the necessary talent is in place to lead organizations.

Equity compensation mix—Last three years  
Employees in the US



We expect that the decrease in the use of performance-based grants in 2009 will turn out to be a temporary reversal of the larger trend related to the increase in performance-based grants. Indeed, the recent attention given to risk-adjusted performance metrics, as well as uncertainty around the duration of the market decline, has led many companies to take their performance grants back to the drafting table. In rethinking performance metrics, companies are looking at the length of a performance period and combining individual and business-unit or company financial and operational targets.

Further, we expect to see companies increase grants of service-based stock options in anticipation of stock price rebound. Certainly, the performance of markets during the latter half of 2009 featured rebounding stock prices. However, the strength of the economy remains uncertain. As signs of sustainable growth emerge and take form, organizations will need to continuously realign their strategic equity compensation practices so as to enable their organizations to launch their own rebounds.

The recent economic turmoil has led to difficulties with the traditional ways of linking broad employee groups to company performance. We are seeing some trends in the declining use of employee stock purchase plans (ESPPs), a popular vehicle for instilling shareholder mind-set in broad employee populations. However, in some countries—particularly in emerging markets—ESPPs actually became more prevalent in 2009 than in 2007.

### Emerging markets

The divergence in trends related to ESPPs in both more-developed countries and emerging markets is not isolated and is reflected in other trends in equity compensation. In 2009, the majority of companies did not plan to increase the number of countries where equity compensation is granted. Some companies reported strategic decisions to start making grants to employees in certain countries in Asia Pacific, the Middle East and Latin America, including Uzbekistan, Kuwait, Saudi Arabia, Argentina, and Mexico. Many of those countries have seen gains from commodity prices over recent years, and the disparate equity compensation practices there likely reflect the unique recruiting and retention goals. Overall, service-based grants tend to be the primary vehicles used in emerging markets, although performance-based grants are used for upper-level executives in those countries.

### IFRS compliance and convergence

International Financial Reporting Standards (IFRS) are now required in many countries, and US convergence is expected in the future. With that context in mind, we know our survey participants are adjusting to the unique accounting requirements under IFRS as they build processes and controls related to IFRS compliance throughout their organizations.

As IFRS and US GAAP (generally accepted accounting principles) converge, standards are being introduced that will drive accounting changes and have immediate impacts on compensation structures and practices. Many companies will need to make significant changes so they will be able to comply with stock-based compensation accounting under IFRS. Some of the key areas that merit analysis are:

- Changes to valuation and expensing
- Equity vs. liability classification
- Accounting for income tax effects

## Tax compliance

One of the biggest challenges to companies that grant equity in more than one country is the diversity of tax rules related to equity compensation across countries. As we know, those rules are not static, and they can change several times—sometimes dramatically—over the life of a stock option grant. Additionally, an often-lamented difference between compliance for book and tax purposes is that for tax purposes, there is no so-called materiality threshold shielding companies from penalties on inaccurately reported or inaccurately paid tax or from the hassle of an audit by the tax authorities.

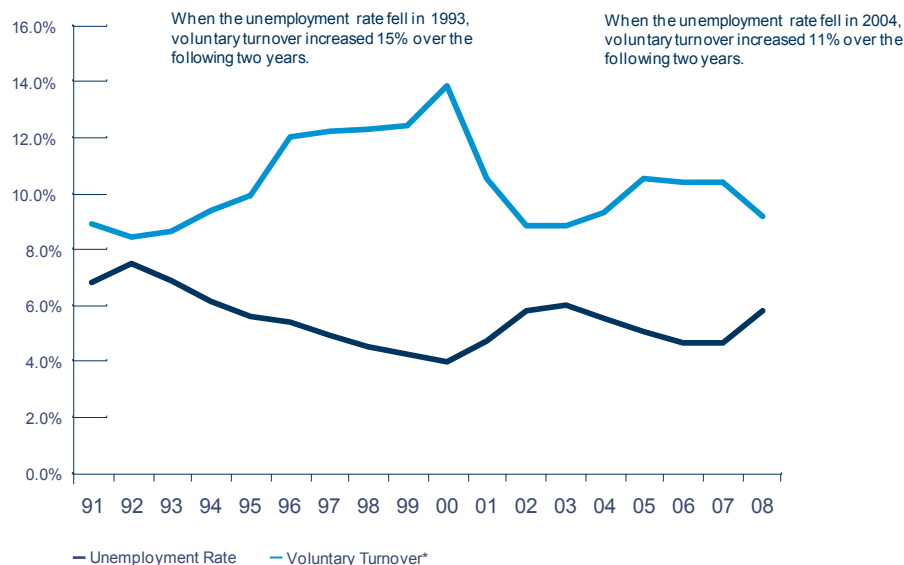
The recent economic decline has exacerbated those situations, with the taxing authorities in several countries announcing new revenue-generation programs related to equity compensation. Despite those initiatives, nearly half of survey participants indicate they have not performed compliance reviews in all countries where equity compensation is offered.

## Conclusion

Results from the 2009 Global Equity Incentives Survey indicate that companies have considered broader economic conditions with respect to global equity compensation policies and practices. The hotbed of issues related to compliance and personal accountability for equity compensation only escalated in 2009, and equity compensation remains the single most-cited tool for enlisting talent throughout to guide companies' resurgence. Companies are positioning themselves for recovery, and it is clear that the benefits of equity compensation continue to outweigh their costs.

# Metric of the Month: high-performer separation rate

Although turnover is comparatively low for most organizations, a recent webcast hosted by PwC Saratoga on reinventing the exit survey demonstrates that many organizations recognize turnover rates will increase as the economy improves. As the chart below notes, when the economy came out of the recession in the early 90s and the dot-com burst in 2000, voluntary turnover increased as the economy improved.



The recession of 2008 has required organizations to push hard on their current staff, a fact recognized by many organizations. A recent poll conducted by PwC Saratoga of 288 organizations found that nearly three-quarters expect turnover to increase for their organization in 2010. The first employees likely to leave organizations will be employees in pivotal roles and high performers.

Though PwC Saratoga does not benchmark pivotal role turnover as part of our annual benchmark report because of the variability of pivotal role by organization, we do offer a metric assessing high-performer turnover.

PwC Saratoga's formula for calculating high-performer separation rate is:

$$\frac{\text{Total High-Performer Turnover}}{\text{High-Performer Headcount}}$$

PwC Saratoga defines high performers as those employees who fall within the top ranking or top 20 percent of your performance ranking system. PwC Saratoga benchmark results show variability by industry, with professional service and insurance companies reporting the highest turnover for high performers and utility and manufacturing firms reporting the lowest turnover.



To learn more about PwC Saratoga's measurement programs, visit [www.pwc.com/saratoga](http://www.pwc.com/saratoga) or call (866) 727-2864.

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