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Designing Innovative Long-Term Incentives for Executives at Newly Public Companies

After an IPO, executives typically end up with significant value in their equity holdings, but retention and motivation can still be a concern in the years that follow.

The market for initial public offerings (IPOs) is expected to heat up this year after a slow 2016. If you're in the planning stages for a public offering or have just gone through one, it's a good time to review your current pay programs to look for ways to add additional retention hooks that will keep your executive team together following a successful liquidity event.

When we partner with clients going through an IPO, much of our work tends to focus on a broad checklist of compensation and HR housekeeping items pertinent to going public— from including an evergreen provision in the equity plan to compensation disclosures to installing new corporate governance policies. However, we also help clients ensure their executives are well-positioned to carry the company into its next phase of growth. Equity is typically a critical vehicle for attracting, motivating and retaining a team at this stage, and just prior to an IPO, companies should always revisit equity one last time to double check executives will remain focused and locked-in following the IPO. Also, after an examination of post-IPO unvested awards and their potential holding power, companies may choose to make one last "true-up" or "top-off" grant.

Once a company goes public and the frenzy of IPO preparation dies down, boards may be asking themselves "What's next?" for our executive compensation plans. Executive pay will naturally evolve in the years following an IPO; bonus targets may increase now that the company has more cash on hand and performance measures might shift from a revenue growth to profit orientation. However, there is a broader question boards should contemplate: How do executives stay incentivized when they have just earned significant equity value by taking their company public? Furthermore, leaders who've gone through a successful IPO are in short supply and will be attractive candidates for other pre-IPO companies who can offer the allure of another home run opportunity.

For context, the table below displays the median value of executive ownership stakes immediately following US IPOs at technology and life sciences companies in 2015 and 2016. Our data covers all named executive officers in regulatory filings, including the CEO, and is broken out to show data for non-founders vs. founders.

Equity Ownership & Equity Value at IPO (50th Percentile)

Founder vs. Non-Founder NEOs	Tenure at Company at IPO (Years)	% Basic Ownership Pre-IPO	% Basic Ownership Post-IPO	Value of Equity Ownership at IPO
All Incumbents (N=328)	2.7	1.86%	1.45%	$4.00 million
Non-Founders (N=272)	2.2	1.56%	1.13%	$2.96 million
Founders (N=56)	7.8	7.09%	5.41%	$18.78 million

Source: Radford Prospectus Database

Separating out the same dataset for CEOs by industry, we find CEOs at internet/e-commerce companies have the highest equity values upon going public. However, the sample size of internet companies going public in the past two years is small, especially relative to the biopharma industry where 51 companies went public and CEOs held a median equity value of $3.45 million at IPO.

CEO Equity Value at IPO (50th Percentile)

Industry	N-count	Median CEO Equity Value at IPO
Biopharma	51	$3.45 million
Communications Products/Services	3	$4.03 million
Hardware	6	$3.45 million
Internet/E-Commerce	7	$43.26 million
Medical Device	9	$3.56 million
Semiconductor	4	$2.98 million
Software	13	$3.58 million

Source: Radford Prospectus Database

Post-IPO Long-Term Incentive Plan Design

Following an IPO, companies want to continue providing meaningful long-term incentive opportunities to their executive teams. This can be a challenge in the public company context, where offering a pay package above the competitive market median is viewed more negatively. One alternative we see as effective at Radford is to deliver median long-term incentive (LTI) opportunities via time-vesting vehicles (typically options, restricted stock units, or a blend of the two) and then layering on a performance share program to deliver 75th percentile pay opportunities. These performance share units are usually tied to a stretch goal that is then linked to the go-forward business strategy. If this LTI plan is easily communicated to executives and shareholders, it can send a powerful message to stakeholders about strong alignment between pay and performance. Here's what a long-term incentive grant of this nature might look like:

- A grant of time-vested options (50%) and restricted stock units (50%) with a target value approximating the market median.
- An additional award of performance share units with a target value approximating the difference between the market 75th percentile and the market median, where vesting is tied to a stretch goal, such as a historically high relative or absolute stock value, accelerated revenue growth or increased profitability at technology companies, or the approval of a new drug at biopharma companies.
- If desired, additional leverage can be incorporated to provide for an even greater upside opportunity if the goal is achieved.

Designing a performance plan with stretch goals and greater upside potential is easier at newly public companies. When the JOBS Act passed in 2012, it provided boards with more flexibility in the design of long-term equity incentives. Emerging growth companies (defined as those with less than $1 billion in annual revenue) typically have up to five years from the date of an IPO before they have to hold a shareholder say-on-pay vote or include a Compensation Discussion and Analysis (CD&A) in their proxy statement, which can provide greater latitude in pay practices that differ from those of more established companies.

Additionally, newly public companies often benefit from more intimate relationships with their shareholders, many of whom have been with the company since inception, and who often remain on the board for a period of time and continue to hold large equity stakes after an IPO. This makes effective communication on executive pay matters a far easier process than might be typical at more established public companies with diluted shareowner bases.

If your company has gone public in the past 18 months or if you're gearing up to go public within the next three years, it's not too late or too early to consider designing your executive long-term incentive plans with post-IPO retention in mind. To speak with a member of our compensation consulting group about equity plan design or other questions, please write to consulting@radford.com.

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