

Maximizing the Perceived Value of Equity Compensation

An Executive Whitepaper

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Prepared by:

Net Worth Strategies, Inc.
2762 NW Crossing Drive
Suite 200
Bend, OR 97701

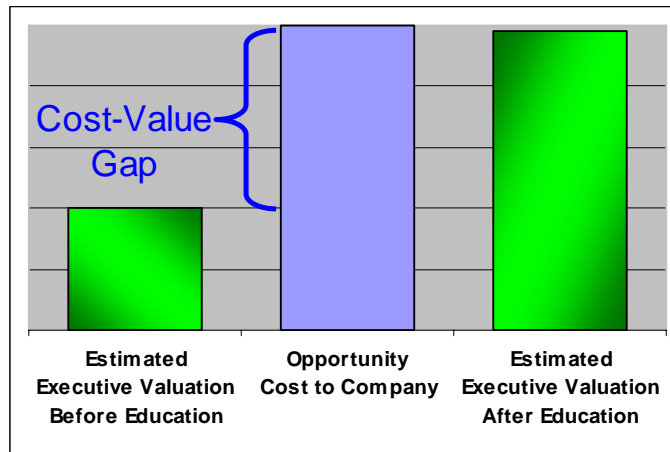
877-728-5964

<http://www.EquityCompensationEducation.com>
<mailto:Info@NetWorthStrategies.com>

I: Executive Summary

The Cost-Value Gap and the Case for Personalized Education

Recent research conducted by faculty at the University of Illinois and Michigan State University finds that, on average, executives value their stock option holdings at 40% of the opportunity cost to the company. More important, however, is their finding that this “cost-value” gap can be closed by employing a short but effective personalized equity education program. The chart below illustrates the opportunity cost of equity compensation and compares it to executive perceptions before and after a personalized education program.



In light of mandatory option expensing and increased shareholder scrutiny, don't companies have a responsibility to take action to close this cost-value gap? As an example, if the opportunity cost to the company is \$50 million, while company executives value their holdings at only \$20 million, shouldn't the company invest in a brief education program to bring the value more in line with the cost?

The Business Case for Personalized Education

A unique characteristic of an education program that can best close the cost-value gap is that it is personalized to each participant. This is achieved by providing participants with an individual analysis (see *Appendix B* for a sample) that is delivered and reviewed at either a group or 1-on-1 workshop with an equity compensation planning specialist. The payoff from personalized equity compensation education comes from the following three areas.

- **Improved retention of key personnel.** As all corporate officers know, the cost and pain of losing even one of your best and brightest can be staggering. Few executives are actively seeking outside employment, but executive search firms are actively seeking them. Although money may not be the primary reason they would take a position elsewhere, most are unwilling to take a financial step backward. It will therefore be difficult for other companies to match the accumulated value of equity compensation that has been granted over a number of years. Consequently,

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if your key people have embraced the full value of their holdings these recruitment discussions are likely to be short lived.

- **Increased motivation of key personnel and alignment with corporate objectives.** Executives who understand and have embraced the upside potential of their holdings, and the importance to their financial goals, are more likely to dedicate themselves to driving earnings and avoiding actions that might jeopardize the stock price. In addition, personalized equity compensation education provides a forum for leadership to engender commitment to long term growth and profitability.
- **Responsibility to owners for the full value from their investment in equity compensation.** As a result of accounting scandals and new regulations, shareholders and groups that represent them have placed a spotlight on the dilution and Income Statement impact of equity compensation programs. To date, the focus has been on the cost side of the equation. As shareholders come to understand the cost-value gap, however, they are likely to focus on the value side as well. Particularly since the cost to close the gap is relatively small.

The cost of a personalized education program including executive and staff time is a small fraction of the increase in perceived value. Yet, a recent research project conducted by the National Center of Employee Ownership found that over half of companies surveyed provide no education on the value of their stock option programs. It is likely these companies either do not understand that a cost-value gap exists or do not have the resources to develop and deliver a personalized education program. The education program cited in the Perceived Value Research has been designed and packaged to address the cost-value gap and minimize the work load impact on staff. This program is called StockOpter Personalized Education and is available through a number of financial services companies.

Assessing the “Cost-Value Gap” at Your Company

The research cited above indicates that the cost-value gap is universal. The extent to which a cost-value gap exists in any particular company can be easily established with a simple assessment. The details of the assessment program are described in *Section IV* of this white paper.

The full white paper can found at:

http://www.equitycompensationeducation.com/Resources/Articles/article_archive.html