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Exploring the Rise in Special Executive Transformational Grants and When to Use Them

There is growing interest in large, one-time grants by all types of companies to help create stronger incentives and alignment with corporate strategy. But the grants also come with risks. We explain when to consider using these them and best practices in implementation.

Large, one-time equity grants to executives have taken hold of the news, boardroom discussions, and the minds of executives who want to leverage these special awards to tie significant pay to significant performance. This style of award is not uncommon in the private equity space but the spark for public companies may largely be attributed to a highly publicized grant made by Tesla to its CEO Elon Musk in 2018. Since then, we have seen multiple companies follow suit (predominantly in the technology and life sciences industries) with their own spin on such an award to help align with the company's long-term strategy or ongoing transformation.

With the rise in popularity of large equity grants, many public companies and their executives are questioning whether they should also take action. Equity awards like this come with significant risks and considerations: the type and level of performance required, the targeted quantum, and the optics to manage both externally with investors and the media as well as internally within the company itself. In this article, we'll walk through those major considerations to help determine if this type of plan works for your company.

How do you measure performance meaningfully?

For large, one-time grants, it is vital to create alignment with shareholders and the company's long-term strategy. As a result, these grants typically vest based on the growth of the company — either through stock price or market cap — and are usually split into multiple tranches, often upwards of 10 to 12. The most rigorous grants also have internal performance metrics tied to each tranche to round out performance and reaffirm that these awards cannot payout simply because of a high-performing stock market. These internal metrics are most consistently tied to earnings and/or revenue, with the awards typically requiring satisfaction of an internal metric goal and a stock price goal in order for each tranche to vest.

In order to ensure the goals are meaningful to investors and help justify the quantum, the required growth is often many multiples of the current company's size. For example, for Tesla's CEO to earn his entire award from the 2018 grant, the company's market cap had to increase by a multiple greater than 10 — from $53 billion to $650 billion. Given the large growth requirement, these grants are often long term in nature with performance periods in the five to 10-year range.

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Finally, the vesting requirements must also align with the company's long-term strategy to harmonize the compensation plans with the company's vision. Publicly disclosing this through the grant can be a powerful message to send externally but also one you cannot take back if a target is missed. Careful consideration should be given to this element.

How Much Is Enough or Too Much?

Award values of this magnitude are often expressed as a percentage of growth created for shareholders. To find that perfect balance of stakeholder value and perception, the larger the grant size, the more rigorous the achievements need to be. For example, if a company currently maintains a $10 billion market cap and intends to become a $20 billion company by the end of the performance period, that is $10 billion in value created for shareholders. Expressing the award's ultimate value as a percentage of the value created for shareholders helps to articulate the value sharing between executives and shareholders.

Targeted values of the award often range between 1-5% of total company value, with the majority on the lower end of the spectrum. Going above this range comes with substantially more risk, and in turn, should be accompanied with more performance rigor and justification. This is all a balancing act at the end of the day. Higher pay should be accompanied by higher shareholder value creation. Further, it is not uncommon for executives to forgo other compensation during the performance period of awards like this to help justify the quantum. Several recent examples are highlighted in the table below:

Figure 1

Examples of Terms and Conditions for Large, One-Time Executive Grants

	Company 1	Company 2	Company 3	Company 4
Vesting Milestones	$50 billion market cap increase per tranche	$14 billion market cap increase per tranche	$1 billion market cap increase per tranche	$24 billion market cap increase per tranche
Operational Metrics	Revenue and EBITA-based milestones	None	Revenue and EBITA-based milestones	None
Number of Tranches	12	9	12	10
Term	10 years	7 years	10 years	10 years
Post-Exercise Holding Period	5 years	2 years	2.5 years	2 years
Grant Date Fair Value	$2.6 billion	$413 million	$246 million	$120 million
% of Value Created for Shareholders	10%	3%	11%	2%

Assessing Optics-Related Risks

How these grants are perceived is important both internally and externally. Starting with the external considerations, shareholder approval will often be needed given the large number of shares typically within the award. Most companies do not have that number of shares easily accessible without completely diminishing the current pool used for all equity awards.

Even if shareholder approval is not required, we recommend seeking approval to help mitigate risks. Large grants with significant quantum at play come with increased scrutiny from investors and proxy advisory firms, presenting greater risk of litigation. Getting shareholder approval, while not a guarantee, can help to mitigate litigation risk from shareholders.

In addition to shareholder pushback, there is potential for employee pushback. These awards are typically awarded to only the CEO or potentially a few other executives that are important to the overall goals. This can make other employees feel like they are not sharing in the success of their work. As a result, some companies have chosen to roll out special broad-based programs at the same time to allow others to share in the success of the company, such as an employee stock purchase plan (ESPP). While it's not a requirement to do something for the broad population, considering how they may react to such a grant is a worthwhile endeavor.

Finally, there are also the optics to manage if the award does not ultimately payout, potentially impacting retention of key executives. Even entertaining a modification if the award becomes unlikely to pay out can make the problem worse. This may also tie up compensation plans for the executives over that timeframe, limiting flexibility to a changing environment. These risks should be weighed carefully during the design phase, so the company is comfortable with this potential outcome.

Good Governance Takes You Far

When it comes to corporate governance and interactions with proxy advisors and investors, there are several potential issues. For example, Institutional Shareholder Services (ISS) and Glass Lewis do not explicitly support grants of this type. They will review the program qualitatively, but it can be difficult to justify an award like this in their eyes. Further, if they view the grants as egregious enough, they may recommend against a company's say-on-pay resolution and/or board member re-elections for multiple years the grant is in effect.

Several things can be explored to help mitigate this risk. First, certain design nuances can be incorporated that help to create even stronger alignment with shareholders, such as a post-vest holding period. This would require the executives to hold the shares for some period of time after vesting to ensure short-term decisions are not made in order to earn the award.

Further, direct shareholder outreach about the program can help. Explaining directly to shareholders why this program is necessary and why you believe in it can be very impactful to getting shareholder support. If shareholders ultimately support the program, the ramifications from proxy advisors tends to be lessened.

Finally, and perhaps most importantly, a solid rationale and disclosure is paramount. Articulating explicitly why this program aligns with the company's goals and is valuable to all stakeholders helps with the qualitative review of these programs and gaining shareholder support. Companies should make sure the rationale behind the award is one the company believes and can support publicly.

Next Steps

Large, one-time grants, often framed as transformational grants, are continually being explored by companies of all sizes and situations to help create stronger incentives and alignment with corporate strategy. Given the size of these awards, grants like this come with significant risks, both internally and externally. Shareholder approval and a proactive investor relations approach can help mitigate some risk. But in the right scenario with the appropriate rigor, quantum, design and governance, both the awardees and shareholders benefit tremendously.

Ultimately, executing on a grant like this is not impossible and can create significant value and alignment for your executive team, but all of the considerations and risks must be weighed to ensure if it's right for your organization.

For questions related to this topic or to speak with one of our equity services experts, please write to rewards-solutions@aon.com.

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