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Consider Compensation Package When Accepting a New Job


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The compensation package is a critical aspect of any decision to take a new position. Yet, many workers often fail to give it the preparation and attention that it deserves. Before beginning this process, you first must recognize your value to the company and what you can bring to its bottom line. Only then can you negotiate a compensation package that is fair to you and the company.

Most people think of compensation as a fixed salary. Salary is only one part of the package, however, and is often the part that is the least flexible and most difficult to negotiate. Companies prefer to pay for performance, not for what you say you can do but what you do. As a result, companies generally fix compensation at lower levels and provide for a bonus tied to performance, department profits or sales, new product launch, restructuring an unprofitable business-whatever objectives you were hired or promoted to achieve.

Just as the company will seek to avoid a high level of fixed compensation, the executive will want to avoid a bonus in a fixed dollar amount. An executive should be able to share in the successes that she has achieved for the company. A performance-based bonus should satisfy the needs of both the executive and the company. Wherever possible, the bonus should be based upon a sliding scale. For instance, 100 percent of base salary if profit reaches a certain level, and a certain percentage of the maximum bonus for lower profit levels.

Increasingly, companies and executives are using deferred compensation, which involves deferring a portion of the executive's compensation to a later year for payment. Generally, this deferral allows the executive to accumulate investment income on the deferred amount. Further, payments of the deferred amount in later years may be subject to the lower federal income tax rates of the Tax Relief Act of 2001.

Generally, the amount deferred is not taxed and is either credited to an account established for the executive together with earnings guaranteed by the company at a certain return rate or invested by the company subject to certain guidelines approved by the executive. Depending upon the amount of compensation deferred, the rate of investment return and the number of years of deferral, the executive can receive a substantial additional payment due to the build-up of investment earnings.

For the tax on the funds to be deferred until the executive receives the funds, she does not have any right to withdraw them. The funds must remain an asset of the company and subject to the claims of its creditors. This is a meaningful risk that must be carefully evaluated by the executive and her advisors. A source of funding for this payment is also critical. If the benefit is unfunded, the company must have the resources to pay the executive the deferred amount together with all earnings at the time it's due.

Cash is often scarce in new ventures, privately held companies or capital-intensive businesses. For these companies to retain and attract key executives, equity or equity-based compensation may be the solution. Depending upon the success of the company, it may be the most lucrative part of the compensation package.

Nonqualified stock options (NSOs), incentive stock options (ISOs) and restricted stock provide an opportunity to receive stock in the company subject to certain restrictions, generally based on the executive's time with the company and her performance. With stock appreciation rights (SARs) and phantom or shadow stock, the executive receives a cash payment tied to the increased value of the company's stock.

But unlike NSOs, ISOs and restricted stock,

Compensation see page 2

Compensation from page 1

SARs do not give the executive an equity interest in the company. Also, with restricted stock, NSOs and ISOs, since the executive is a shareholder when the restrictions terminate or options are exercised, gain on the sale of the shares may be taxed at the lower long-term capital gains rates of 20 percent.

The cash received from phantom stock or SARs is taxed like a cash bonus, at ordinary rates. This difference often is very substantial depending upon the number of shares received or subject to options and the price of the shares at the time the restrictions lapse or options are exercised.

Also important is the time that the restrictions terminate or options vest. If the restrictions lapse or options are exercised within one year from the date the shares are sold, the gain will be ineligible for the more favorable long-term capital gains rate. Each type of equity and equity-based compensation vehicle must meet certain legal and tax requirements that are outside the scope of this article and must be carefully reviewed by an advisor.

Apart from compensation and benefits, the company may also seek a restrictive covenant to prevent the executive from competing with the company after the executive's employment has been terminated. This is a critical aspect of the negotiations since this covenant can prevent the executive from taking a position with another company.

The length of the covenant, its geographic scope and the business restriction must be well defined. Whether the executive will agree to a broad covenant will depend upon the amount of severance and other benefits the executive receives from the company on termination of employment. The executive must fully understand the covenant and what it prevents or restricts to be able to properly negotiate its terms.

A decision to leave a lucrative position and join another company is a very difficult one. Often the executive leaves known opportunities and fully vested benefits. The company should know what the executive is leaving behind so that it can be addressed in the new compensation package. Vesting periods should be maintained and participation in benefit programs duplicated. If immediate participation or vesting cannot be maintained, the executive should be adequately compensated for the difference.

What happens if the company is acquired or there is a change in control over the company, not long after an executive begins her new job? What prevents the acquirer or controlling entity from rejecting the agreement reached, eliminating the executive's position, making significant changes in her duties or responsibilities or otherwise altering the original deal? The company should recognize this risk and be willing to include a provision in the agreement that allows the executive to leave the company's employment and provides for payments of severance, accelerated vesting of options and other benefits in the event of such an acquisition or other "change of control" and, as a result, the executive's position is substantially or adversely changed.

Negotiation of an employment agreement and the compensation package often makes a lasting first impression on a new company. The executive's preparation, diligence, flexibility, practicality, judgment and candor will provide valuable insight into how that executive will perform in her new position. Also, it will be the starting point for her advancement in the company.

Recognize that the company is involved in similar negotiations on a regular basis and, generally, has received expert counseling on various issues. It is often the executive's first negotiation on her own behalf. She must be prepared, gather information, know her industry and the compensation packages of those similarly situated and, in most cases, should seek expert advice.

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