Deloitte.

Thinking about a public offering?
Create executive compensation programs that highlight your priorities to employees and shareholders

MAKING AN IMPACT THAT MATTERS since 1845

IPO readiness: Executive compensation and equity plan design considerations

Becoming a publicly traded company marks a significant milestone in a business's lifecycle, creating a buzz in the office, generating growth opportunities in the market, expanding the corporate identity, and for human resources professionals, it provides new tools to attract and retain talent, and communicate priorities to employees and shareholders.

Human resources professionals have a unique opportunity to make some of the most strategically important decisions to set the company up for future success. Because of the many competing priorities, executive and equity compensation program design and implementation is often rushed during the Initial Public Offering (IPO) launch, limiting the targeted impact of the programs, and often requiring considerable effort and enhancements after the IPO. Recognizing the importance of these programs on organization culture, priority messaging, talent management, and company performance may reinforce the need to invest the necessary amount of time in these programs to begin realizing the return on investment as quickly as possible.

The IPO should prompt the company to reassess its employee value proposition for executives and the broader employee population. Executive compensation and equity programs will be evaluated through a public company lens and should be enhanced to support the company's strategic objectives and, for the first time, to withstand the scrutiny of a public audience comprised of employees, shareholders, proxy advisors, media, and other interested parties.

The following pages highlight some key considerations related to executive and equity compensation design and implementation in contemplation of an IPO.

Compensation philosophy

The six-to-twelve-month period prior to an IPO is an opportune time for a company to establish its public company compensation philosophy. A compensation philosophy lays out an organization's approach to aligning compensation practices with its strategic business and talent objectives and establishes the framework for a company's compensation programs and policies going forward.

Peer group development

Gathering marketplace insights on pay levels and incentive design is one of the first steps in developing public company executive and equity compensation programs.

In anticipation of an IPO, companies will frequently establish an industry peer group of similarly situated publicly-traded companies to evaluate compensation levels of executives and board members, incentive design features, and prevalence of governance measures like share ownership guidelines and change-in-control protection.

Separately, companies should also evaluate practices among a recent IPO peer group to inform decisions around the size of Long-Term Incentive Plan (LTIP) equity share reserve, evergreen provisions, share usage levels, and the design and value of any IPO-related equity awards. The IPO peer group, in conjunction with the industry public company peer group (companies that have been public for a longer period) can help management understand the evolution of executive and equity compensation design as they gain experience and maturity as a public entity.

Market assessment

SEC (Securities and Exchange Commission) disclosure requirements mandate that publicly traded companies disclose information on executive compensation and equity practices.

In the lead up to the public offering, companies should evaluate the alignment of their executive compensation pay levels against the market before the information is shared with the public. At the same time, companies should formalize their independent board of director compensation program, typically using the same industry peer group and published survey data to inform their decisions.

The table below, while not exhaustive, highlights some of the most common elements of pay analyzed.

Upon IPO, some companies may be classified as an emerging growth company (EGC) based on certain size classifications including revenue, non-convertible debt, or market capitalization. EGCs have lesser disclosure requirements, particularly around executive compensation, in comparison to established public companies.

Executive Pay Elements
Base salary
Short-term incentive (quantum and design)
Long-term incentive (quantum and design)
Compensation delivery mix

Board of Director Pay Elements
Cash retainer
Equity retainer (annual and initial)
Committee fees
Lead director and / or chair premiums

In the assessment phase, companies should also consider corporate governance practices such as share ownership guidelines, change-in-control practices, clawback provisions, stockholder engagement program, and policies preventing directors, officers, and employees from hedging against a company's own common stock.

Incentive design

Incentive plans are critical elements of executive compensation programs, used to reinforce behaviors, encourage alignment with shareholders, and communicate priorities to employees, shareholders, and the broader stakeholder universe.

An assessment should be conducted to determine whether the current incentive plans support the company's strategy in the public realm. The plans will typically be disclosed in the public filings and will highlight the company’s priorities through the performance metrics selected (and not selected), the mix of short-term and long-term performance awards, and the leverage, or potential size of the payouts. Once a public company, these plans will now come under scrutiny from shareholders and proxy advisory firms around the types of metrics used and payout amounts. Public company short and long-term incentive plans are largely quantitative with formal plan documents that set forth the performance measures and other plan details. This may differ from pre-IPO practices that often include a discretionary bonus plan and periodic stock option or restricted stock unit grants.

Alongside developing traditional annual and long-term incentive plans prior to the IPO, the company may also consider the need to implement a one-time incentive plan tied to the successful completion of the IPO. Identifying employees who are crucial to the IPO's success and ensuring they are motivated and incentivized to drive the company's growth beyond the listing is of utmost importance for a successful transition.

Beyond executive compensation

While executive compensation design, administration, and disclosure in preparation of a public offering typically absorbs most of the attention, many companies also use the planning period to shore up the broad-based employee compensation plans to support career pathing, succession planning, and compliance activities like pay equity.

Companies may also choose to set up an Employee Stock Purchase Plan (ESPP) at this time. ESPPs are a type of broad-based equity plan that allows employees to purchase shares of their company's stock, usually at a discount. The plans can promote an ownership culture, create wealth accumulation opportunities, and help supplement a competitive rewards program. Even if a company does not plan to immediately implement an ESPP at the time of their IPO, many companies will often seek approval of the plan documents and necessary share reserve, so it does not need to separately seek approval when public.

Due to the increased administration, compliance, and public disclosure requirements in the public company environment, companies may want to evaluate the current systems (e.g., HRIS, equity plan administration, remote work) in place to assess whether they will meet the demands of a public company.

Get in touch

Becoming a publicly traded company is a significant achievement but is also just the beginning of a new journey.

We are here to help. Contact us to arrange a meeting to discuss your organization's needs, respond to an RFP, or answer any other questions.

This article is the first of a series that will cover employee considerations when preparing for an IPO.

Article authors:

Meridith Fronza
Deloitte Tax LLP
mfronza@deloitte.com

Ian Dawson
Deloitte Tax LLP
iadawson@deloitte.com

Gregory Kopp
Deloitte Tax LLP
grkopp@deloitte.com

Abby Dunleavy
Deloitte Tax LLP
adunleavy@deloitte.com

Andy Burdis
Deloitte Tax LLP
aburdis@deloitte.com